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CANADA – EXPORT CREDITS AND LOAN GUARANTEES FOR REGIONAL AIRCRAFT

Report of the Panel

The report of the Panel on *Canada – Export Credits and Loan Guarantees for Regional Aircraft* is being circulated to all Members, pursuant to the *DSU*. The report is being circulated as an unrestricted document from 28 January 2002 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the *DSU* only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

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

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I. INTRODUCTION

A. COMPLAINT OF BRAZIL

1.1 On 22 January 2001, Brazil requested consultations[1] with Canada pursuant to Article XXIII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"), Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), and Article 4 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") regarding certain alleged subsidies granted by the Government of Canada and the Province of Québec that support the export of regional aircraft from Canada.

1.2 Brazil and Canada held consultations on 21 February 2001, but failed to reach a mutually satisfactory solution.

1.3 On 1 March 2001, Brazil requested the establishment of a panel pursuant to Article XXIII of the GATT 1994, Article 6 of the DSU, and Article 4.4 of the SCM Agreement.[2]

B. ESTABLISHMENT AND COMPOSITION OF THE PANEL

1.4 The Dispute Settlement Body ("DSB") established a panel on 12 March 2001, with standard terms of reference. The terms of reference of the Panel are:

> To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS222/2, the matter referred to the DSB by Brazil in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

1.5 On 7 May 2001, Brazil requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the DSU. This paragraph provides:

> If there is no agreement on the panelists within 20 days after the date of the establishment of a panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request.[3]

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[1] *See* WT/DS222/1.
[2] *See* WT/DS222/2.
[3] Paragraph 12 of Article 4 of the SCM Agreement provides:

> For purposes of disputes conducted pursuant to this Article, except for time-periods specifically prescribed in this Article, time-periods applicable under the DSU for the conduct of such disputes shall be half the time prescribed therein.

1.6 On 11 May 2001, the Director-General accordingly composed the panel as follows:

Chairman: Prof. William J. Davey

Members: Prof. Seung Wha Chang
Ms. Usha Dwarka-Canabady

1.7 Australia, the European Communities, India, and the United States reserved their rights to participate in the panel proceedings as third parties.

C. PANEL PROCEEDINGS

1.8 The Panel met with the parties on 27 and 28 June 2001, and on 31 July 2001. The Panel met with the third parties on 27 June 2001.

1.9 The Panel submitted its interim report to the parties on 19 October 2001. Comments from the parties on the interim report were received on 26 October 2001, and on each other's comments on 2 November 2001 (*See* Section VI, *infra*). The Panel submitted its final report to the parties on 9 November 2001.

II. FACTUAL ASPECTS

2.1 This dispute concerns various Canadian measures which Brazil alleges are subsidies inconsistent with Canada's obligations under Article 3.1(a)[4] of the SCM Agreement in that they are contingent in law or in fact, whether solely or as one of several other conditions, upon export performance.[5]

2.2 The measures as identified in Brazil's request for the establishment of a panel are export credits, including financing, loan guarantees, or interest rate support provided by or through the Export Development Corporation ("EDC") – both Canada and Corporate Accounts thereunder – to facilitate the export of civil aircraft, and export credits and guarantees, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees", provided by *Investissement Québec* ("*IQ*"), a programme operated by the Province of Québec.

III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

A. BRAZIL

3.1 In its request for establishment, Brazil requests that the panel find that:

1. Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement.

2. Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

3. Canada, in defiance of the rulings and recommendations of the Dispute Settlement Body, continues to grant or offers to grant export credits to the regional aircraft industry through the

[4] We understand Brazil's reference in its request for the establishment of a panel to Article 3 of the SCM Agreement to mean Article 3.1(a) of the Agreement.

[5] *See* footnote 14, *infra*.

Canada Account, that are prohibited subsidies within the meaning of Articles 1 and 3 of the Agreement.

4. Canada's grant or offer to grant Canada Account export credits to Air Wisconsin is a prohibited export subsidy within the meaning of Articles 1 and 3 of the Agreement.

5. Export credits, including financing, loan guarantees, or interest rate support by or through the EDC are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

6. Canada's grant or offer to grant export credits by or through EDC to Air Wisconsin is a prohibited export subsidy within the meaning of Articles 1 and 3 of the Agreement.

7. Export credits and guarantees provided by *Investissement Québec*, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees" are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.[6]

3.2 Brazil further requested that the Panel recommend that the DSB direct Canada to withdraw these prohibited subsidies without delay.[7]

B. CANADA

3.3 Canada requests that the Panel find that Brazil has failed to present a *prima facie* case that any of the Canada Account, Corporate Account or *IQ* programmes, "as such", "as applied" or in respect of "specific transactions" are inconsistent with Canada's obligations under the SCM Agreement.[8]

3.4 Canada considers that:

1. There is no basis for this Panel to reverse the findings in *Canada – Aircraft* [9] that EDC (Corporate Account) and Canada Account are discretionary;

2. *IQ* is not "as such" inconsistent with the SCM Agreement;

3. Brazil's "as such" claims would improperly condemn all ECAs, and are at odds with the facts and the law;

4. Brazil seeks to make an untenable distinction between its challenges to measures "as applied" and in respect of "specific transactions"; and

5. Brazil has failed to show that any specific transactions, under Corporate Account, *IQ* or Canada Account, including Air Wisconsin, are inconsistent with Canada's obligations under the SCM Agreement, because they are not inconsistent.

IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties are set out in their submissions to the Panel. The parties' submissions are attached to this Report as Annexes (*See* List of Annexes, page v).

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[6] WT/DS222/2.

[7] *Id.*

[8] Canada also raises a number of preliminary objections in respect of the claims of Brazil. *See* para. 7.3, *infra*.

[9] *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), Report of the Panel, WT/DS70/R, and Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999.

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of the third parties – Australia, the European Communities, India, and the United States – are set out in their submissions to the Panel and are attached to this Report as Annexes (*See* List of Annexes, page v).

VI. INTERIM REVIEW

6.1 On 26 October 2001, both parties submitted written requests for review by the Panel of particular aspects of the interim report issued on 19 October 2001. On 2 November 2001, each party provided written comments on certain aspects of the other party's request for interim review. Neither party requested an additional meeting with the Panel. The issues raised by the parties are addressed below. The Panel deleted paragraph 7.263 of the interim report, and made minor changes to paragraphs 7.243, 7.256, 7.259, 7.262, 7.276, and 7.284 of the interim report.

A. BRAZIL'S REQUEST FOR INTERIM REVIEW

6.2 Brazil drew the attention of the Panel to a number of typographical and factual errors in the interim report, which we have corrected.

6.3 Brazil requested a change to the Panel's description of Brazil's argument in paragraph 7.221 of the interim report. Canada denied the need for any such change. In order to avoid any misunderstanding, we have deleted that paragraph from the final version of our report.

6.4 Brazil requested the inclusion of a note to paragraph 7.226 of the interim report, to the effect that Brazil was able to obtain details of Embraer's offer to Air Wisconsin. Canada objected to the note requested by Brazil, in part because Brazil obtained those details in response to a direct request from the Panel. In our view, the fact that Brazil was able to obtain details of an offer made by Embraer in response to a request from the Panel has no bearing on the issue of whether or not it would be realistic to expect the EDC to have access to data regarding commercial financing transactions involving Bombardier aircraft. We therefore decline to include the note requested by Brazil.

6.5 With regard to note 278 of the interim report, Brazil relies on Exhibit CAN-61 to suggest that CQC participated in the Midway transaction as an equity investor. In response, Canada asserted that "[n]either IQ nor CQC were equity participants in the Midway transaction". Canada also confirmed the factual accuracy of note 278 of the interim report. In light of Canada's response, we have not made any changes to note 278 of the interim report.

B. CANADA'S REQUEST FOR INTERIM REVIEW

6.6 Canada drew the attention of the Panel to a number of typographical and factual errors in the interim report. In some cases we have corrected the error. In other cases we have made deletions.

6.7 Canada objects to the Panel's statement in para. 7.18 of the interim report that "the legal framework under which the Canada Account is operated has changed", indicating that it has not and referring to Canada's oral response to that effect to a question by the Panel at the second meeting with the parties. Brazil asserts that the legal framework under which the Canada Account operates has changed.

6.8 The Panel makes the relevant statement in the context of its assessment of Canada's request for a preliminary ruling under Article 21.5 of the DSU in respect of Brazil's Claims 1 and 3. The basis for the Panel's statement is that, following the *Canada – Aircraft* panel's decision, Canada enacted the

Policy Directive GEN 000-004 – Submission of Documents to the Government of Canada[10] and the *EDC Canada Account Policy Guideline*[11], which require Canada Account financing to comply with the OECD Arrangement (*See* paragraph 7.93, *infra*). We note also that Brazil disagrees with Canada's objection, pointing to the policy memorandum enacted by Canada following the first *Canada – Aircraft* dispute. Accordingly, we retain the statement in para. 7.18 of the interim report, and have included note 21 in the final report for clarification.

6.9 Canada requested a change to the Panel's description of its argument in the last sentence of paragraph 7.145 of the interim report. Brazil has objected to the change requested by Canada. Since we do not consider that the current version is inaccurate in any way, we decline to make the change requested by Canada.

6.10 Canada questioned the factual accuracy of a statement made by the Panel in the third sentence of paragraphs 7.152 and 7.316 of the interim report. Brazil objected to the concern raised by Canada, largely because Canada failed to make the relevant argument during the substantive part of the proceedings. In order to avoid any factual error in our findings, we have deleted the third sentence of paragraphs 7.152 and 7.316 of the interim report.

6.11 With regard to paragraph 7.247 of the interim report, Canada objected to the Panel's addition of 20-30 basis points to large aircraft EETC spreads to arrive at an appropriate regional aircraft spread. The Panel made this adjustment in response to Brazil's reliance on statements made by Canada in the *Brazil – Aircraft – Second 21.5* proceedings (*See* paragraphs 47 and 50 of Oral Statement of Brazil at the Second Meeting of the Panel (Annex A-12)). In responding to Brazil's oral statement[12], Canada made no attempt to deny the need for a 20-30 basis point adjustment when converting from large aircraft to regional aircraft spreads. Nor did Canada object to Brazil's inclusion of a 20 basis point adjustment ("for the difference between the regional aircraft used in the financing at issue and the larger jets used in the typical EETC issue") in its Exhibit BRA-66. Furthermore, although Canada asserts that "[v]ariations in pricing between similar but non-identical asset classes are dynamic and subject to change …", Canada does not deny the need for an adjustment *per se*. However, although Canada appears to accept the need for an adjustment of some sort, Canada fails to indicate what would be, in its view, an appropriate adjustment for the transactions at issue. In addition, we note that a lesser adjustment would not necessarily change the outcome of our findings. For these reasons, we see no need to change paragraph 7.247 of the interim report.

6.12 Regarding paragraph 7.255 of the interim report, Canada made a number of arguments as to why FMC data could be used to assess transactions in certain circumstances. In doing so, however, Canada "does not [] reject Brazil's observation that the FMC represents an average of current pricing levels of the bonds of a wide range of similarly rated companies". Since it is the inclusion of average data that caused the Panel not to base its findings on FMC data, and since Canada has not denied that average data were included, we make no changes to paragraph 7.255 of the interim report.

6.13 In respect of paragraph 7.276 of the interim report, Canada asserted that the Panel should not have concluded that EDC financing [] does not include an []. Canada submits that the fixed margin for credit risk [] on the authority of the President or Senior Vice President Finance and Chief Financial Officer of the EDC. According to Canada, "an authorized margin [] the identified fixed margin is [] for that transaction". Brazil objected to any change to paragraph 7.276 of the interim report.

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[10] Exhibit CAN-16.

[11] Exhibit CAN-17.

[12] *See* Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12).

6.14 We note that the EDC offered financing [] to Comair in two instances: in July 1996 and August 1997. Canada submitted EDC Pricing Documentation regarding these offers in the form of Exhibit CAN-59. This exhibit does not contain any details regarding the basis on which the President or Senior Vice President Finance and Chief Financial Officer of the EDC may have authorised [] the fixed margin for credit risk. Nor does it contain any data indicating that any margin authorised by the President or Senior Vice President Finance and Chief Financial Officer of the EDC was [] for the two transactions at issue. For these reasons, we reject Canada's assertion that the Panel should not have concluded that the relevant EDC financing [] does not include [].

VII. FINDINGS

A. INTRODUCTION

7.1 This dispute concerns export credits, including financing, loan guarantees, or interest rate support provided by or through the Canada-owned EDC – both Canada and Corporate Accounts thereunder – to facilitate the export of civil aircraft as well as export credits and guarantees, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees", provided by *IQ*, a programme operated by the Province of Québec. Brazil claims that the EDC and *IQ* programmes "as such" and "as applied" are prohibited export subsidies, in violation of Article 3.1(a)[13] of the SCM Agreement. Brazil also claims that specific transactions under those programmes constitute prohibited export subsidies.[14]

7.2 After addressing certain preliminary issues raised by Canada, we shall begin our substantive review by examining Brazil's claims regarding the EDC programmes "as such" and "as applied". We shall then turn to Brazil's claims regarding specific transactions under those programmes. In examining specific transactions, we shall first review Brazil's claims regarding EDC support to Air Wisconsin. We shall then address Brazil's claims regarding other EDC support, before turning to Brazil's claims regarding support provided by *IQ*.

B. PRELIMINARY ISSUES

7.3 Canada raises the following preliminary objections in respect of the claims of Brazil:

1. Claims 1, 2, and 3 raise issues of compliance or implementation related to another dispute. These claims are inconsistent with Article 21.5 of the DSU. This panel does not have the jurisdiction to examine compliance issues that have arisen in other disputes; and

[13] As noted above, we understand Brazil's reference in its request for the establishment of a panel to Article 3 of the SCM Agreement to mean Article 3.1(a) of the Agreement.

[14] The Panel asked Brazil to "identify the specific measures in respect of which Brazil is requesting the Panel to make findings. In particular, is Brazil requesting findings (1) on the Canada Account, EDC and *IQ* programmes as such, (2) on the Canada Account, EDC and *IQ* programmes as applied (on the basis of evidence regarding specific transactions), (3) on the specific Canada Account, EDC and *IQ* transactions identified in its first submission, or (4) on some combination of (1), (2) and (3)?" Brazil replied that it "is requesting findings by the Panel on points (1), (2), and (3). Brazil is requesting that the Panel find the Canada Account, EDC and *IQ* programmes as such inconsistent with Canada's obligations under the SCM Agreement. Brazil is also requesting that the Panel find the Canada Account, EDC and *IQ* programmes inconsistent with Canada's obligations under the SCM Agreement as applied on the basis of evidence regarding specific transactions. Finally, Brazil is requesting that the Panel find the specific Canada Account, EDC and *IQ* transactions identified in its First Written Submission as breaching Canada's obligations under the SCM Agreement" (Response of Brazil to Question 25 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9)).

2. Claims 1, 2, 5, and 7 are inconsistent with the requirements of Article 6.2 of the DSU, which require a complaining party to identify the specific matters at issue and to provide a brief summary of the legal basis of the complaint, sufficient to present the problem clearly. Brazil has not met the minimum standards of this provision.

1. Disputes over implementation – Article 21.5 of the DSU (regarding claims 1, 2, and 3 of Brazil)

(a) Arguments of the parties

(i) Canada

7.4 Canada argues that the DSU provides that disputes over implementation are to be resolved through expedited proceedings provided for in Article 21.5, rather than through new panel proceedings. Canada further points out that Article 21.5 uses mandatory, not hortatory, language. Where there is disagreement over implementation, such a dispute "shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel". Canada submits that, in all cases to date in which there has been a dispute over the existence or WTO-consistency of measures taken to comply with DSB recommendations or rulings, resort has been had to Article 21.5. In Canada's view, to allow a Member to ignore the specific requirements of Article 21.5 and instead to resort to *de novo* panel proceedings to determine issues of implementation would be contrary to Article 21.5. Moreover, any panel established through the regular dispute settlement procedures of Article 6 of the DSU would not have the jurisdiction to make findings on issues of compliance arising from other cases.

Claim 1

7.5 Canada recalls that Claim 1 states:

> Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.6 Canada points out that, in this claim, Brazil asserts in part that certain export credits "continue to be" prohibited export subsidies. Canada argues that all measures of a Member are presumed to be WTO-consistent absent a specific DSB ruling to the contrary. Therefore, the reference by Brazil to export credits that "continue to be" prohibited export subsidies must refer back to earlier DSB rulings that certain "export credits" granted by Canada are not WTO-consistent. According to Canada, this would appear to be a claim that Canada has not complied with the DSB rulings in *Canada – Aircraft*. Canada argues that this panel does not have the jurisdiction to determine issues of compliance related to other cases.

Claim 2

7.7 Canada recalls that Claim 2 states:

> Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

7.8 Canada submits that Claim 2 fails to specify which "report of the Article 21.5 panel" is the subject of the current Brazilian complaint. Canada presumes that it is the report of the Article 21.5 panel in *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"). In any event, argues Canada, a complaint that Canada "has not implemented" the Article 21.5 panel report is clearly

an issue of compliance or implementation related to an earlier dispute, which is outside the jurisdiction of the present panel.

Claim 3

7.9 Canada recalls that Claim 3 provides:

> Canada, in defiance of the rulings and recommendations of the Dispute Settlement Body, continues to grant or offers to grant export credits to the regional aircraft industry through the Canada Account, that are prohibited subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.10 Once again, argues Canada, Brazil has referred to "the rulings and recommendations of the Dispute Settlement Body", without any reference as to which such rulings or recommendations are the subject of the current complaint. Again, Canada surmises that Brazil is referring to the rulings and recommendations of the DSB in *Canada – Aircraft*. The reference to the alleged granting of, or offers to grant, prohibited subsidies "in defiance of" the DSB rulings clearly indicates, in the opinion of Canada, that this claim raises issues of compliance with earlier rulings. Such claims are outside the jurisdiction of the current panel according to Canada.

(ii) Brazil

7.11 Brazil disagrees that it cannot challenge, in proceedings brought pursuant to Article 6 of the DSU, the existence or consistency of measures taken to comply with the earlier recommendations and rulings of the DSB with respect to the Canada Account. While it is the case, in the view of Brazil, that a Member may challenge under Article 21.5 "measures taken to comply" with DSB recommendations and rulings, the ordinary meaning of Article 6.2 of the DSU and Articles 4.1, 4.4, and 4.5 of the SCM Agreement do not preclude a Member from similarly bringing a new dispute settlement proceeding under those provisions. Brazil argues that, if a Member chooses to forego the expedited procedures under Article 21.5, it is its prerogative to do so, and requiring Members to avail themselves of only those expedited procedures would be contrary to the object and purpose of Article 21.5. Brazil further posits that, in the circumstances of this particular case, it "considered it efficient to forego Article 21.5's expedited procedures"[15], as Brazil's challenge to Canada Account support for regional aircraft involves claims against the measure both as such and as applied in particular transactions, and a panel constituted under Article 21.5 would not be authorised to review the consistency of Canada Account support as applied in particular regional aircraft transactions.

7.12 Further, Brazil considers that Canada is incorrect to identify each of the numbered paragraphs regarding the Canada Account in Brazil's request for the establishment of a panel as a separate claim. Brazil submits that it makes one overarching claim with respect to Canada Account support in its request for establishment, in paragraph 1. Paragraphs 2-4 of the request explain the nature of that claim, according to Brazil.

7.13 Brazil submits that the *Canada – Aircraft* panel did not rule that Canada Account as such was consistent with the SCM Agreement. It found that Brazil had failed to make a *prima facie* case and, as a result, the Panel could not "make any findings on the Canada Account programme *per se*."[16] With respect to Canada Account, Brazil argues that it has now presented additional information and evidence that presents a *prima facie* case.

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[15] Response of Brazil to Submission of Canada Regarding Jurisdictional Issues, para. 8 (Annex A-4).
[16] *Canada – Aircraft*, Report of the Panel, footnote 9, *supra*, para. 9.213.

(b) Evaluation by the Panel

(i) Claims 1 and 3

7.14 We recall that Claims 1 and 3 read as follows:

Claim 1

> Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

Claim 3

> Canada, in defiance of the rulings and recommendations of the Dispute Settlement Body, continues to grant or offers to grant export credits to the regional aircraft industry through the Canada Account, that are prohibited subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.15 In essence, Canada argues that Claims 1 and 3 are claims related to the implementation of the DSB recommendations in *Canada – Aircraft*, and that this panel does not have the jurisdiction to determine issues of compliance related to other cases. In our view, however, the use of the words "continue to be" and "in defiance of the rulings and recommendations of the [DSB]" do not necessarily indicate that what is sought by Brazil is a review of "measures taken to comply with" the DSB recommendations, as that term is used in Article 21.5 of the DSU. Indeed, Brazil, in its response to our question, submits that it "is not asking this Panel to review the findings of the DS70 Article 21.5 Panel or to uphold or confirm the findings of that Panel. Similarly, Brazil is not asking this Panel to draw conclusions as to what Canada should have done." Thus, in our view, the present panel has not been asked to rule on whether Canada implemented the DSB recommendations in the *Canada – Aircraft* case.

7.16 In our view, the wording of both Claims 1 and 3 alleges current violations of Article 3.1(a) of the SCM Agreement, which sets out the prohibition on export subsidies and reads as follows:

> 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 deleted);

To prove the existence of an export subsidy within the meaning of this provision, a Member must therefore establish (i) the existence of a subsidy within the meaning of Article 1 of the SCM Agreement and (ii) contingency of that subsidy upon export performance. It is these elements that must be set out for purposes of a claim under Article 3.1(a). In this regard, we consider that the phrases "continue to be" and "in defiance of the rulings and recommendations of the [DSB]" – which form the basis for Canada's preliminary objection in respect of Claims 1 and 3 – are surplus. What Brazil must prove to carry its Article 3.1(a) claims are the elements necessary under that provision. In our view, the above phrases used by Brazil in its request for establishment and subsequently cited by Canada are simply not relevant to Brazil's claims under Article 3.1(a). Accordingly, our focus must be on whether Brazil has set out the elements necessary under Article 3.1(a), and that is what we shall address.

7.17 We note that, in respect of Claims 1 and 3, Brazil states that "Brazil simply is requesting a factual finding that, since the adoption of the DS70 Article 21.5 Report, Canada has not made any

changes in Canada Account"[17]. With regard to this "factual finding" requested by Brazil, we recall that Article 11 of the DSU – which sets out the function of panels – states in relevant part:

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

We further note that the terms of reference of this panel are:

> To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS222/2, the matter referred to the DSB by Brazil in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

We do not consider that the "factual finding" requested by Brazil is a "matter" we should objectively assess or examine in this case. It is simply not relevant to whether Brazil has established its Article 3.1(a) claims in this proceeding, which we consider to be "such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the [SCM Agreement]".[18]

7.18 Finally, we note that, whether or not the phrases "and continue to be" and "in defiance of the rulings and recommendations of the [DSB]" are viewed as irrelevant surplus in respect of Claims 1 and 3, we view the claims in this proceeding to be different and broader than those that were the subject of the *Canada – Aircraft* ruling. The *Canada – Aircraft* panel held that "the Canada Account debt financing at issue constitutes 'subsid[ies] contingent in law . . . upon export performance' prohibited by Article 3.1(a) of the SCM Agreement"[19]. The Panel had found that "the Canada Account debt financing in issue takes the form of export credits"[20]. Claims 1 and 3 of Brazil are made, respectively, in relation to "[e]xport credits, including financing, loan guarantees, or interest rate support, by or through the Canada Account" and "export credits . . . through the Canada Account". Brazil's claims in this proceeding do not concern the specific financing transactions "at issue" in the *Canada – Aircraft* case. Rather, different transactions are at issue. Moreover, the legal framework under which the Canada Account is operated has changed, as noted below.[21] The scope of the *Canada – Aircraft* ruling is therefore different and narrower than that of the ruling requested of the present panel.

7.19 For the foregoing reasons, we reject Canada's objection to Claims 1 and 3.

(ii) Claim 2

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[17] Response of Brazil to Question 27 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9).

[18] Brazil's request for a factual finding seems to be based on Claim 2, which we find is not within our terms of reference (*See* paras. 7.45-7.49, *infra*.). To the extent that it might also be based on other claims of Brazil, we address it as such.

[19] *Canada – Aircraft*, Report of the Panel, footnote 9, *supra*, para. 9.231.

[20] *Id.*, para. 9.230.

[21] In this regard, we note the fact that, following the ruling of the *Canada – Aircraft* panel, Canada enacted the *Policy Directive GEN 000-004 – Submission of Documents to the Government of Canada* (Exhibit CAN-16) and the *EDC Canada Account Policy Guideline* (Exhibit CAN-17), which require Canada Account financing to comply with the *OECD Arrangement* (*See* para. 7.93, *infra*).

7.20 We note that Canada has also requested a preliminary ruling under Article 6.2 in respect of Claim 2 (*See* paragraph 7.25, *infra*). In light of our ruling in that regard (*See* paragraph 7.49, *infra*), we need not, and do not, address Canada's request for a preliminary ruling under Article 21.5 in respect of Claim 2.

2. Specificity of the Request for the Establishment of a Panel – Article 6.2 of the DSU (regarding claims 1, 2, 5, and 7 of Brazil)

(a) Arguments of the parties

(i) Canada

7.21 Canada recalls that requests for the establishment of a panel must comply with the requirements of Article 6.2 of the DSU, which provides in part:

> The request for the establishment of a panel . . . shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

7.22 Citing various Appellate Body statements, Canada emphasises the due process objective of Article 6.2 and submits that a deficiency in the request for the establishment of a panel cannot be cured by later submissions. Further, Canada recalls that, in determining whether Article 6.2 has been violated, panels and the Appellate Body have taken into account whether there has been prejudice to the rights of defence of the defending party during the course of the panel proceedings.

Claim 1

7.23 Canada recalls that Claim 1 states:

> Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.24 Canada considers that the reference to "export credits" in Claim 1 is extremely broad. Any practice that allows payment to be deferred for an exported good or service could conceivably qualify as an "export credit" according to Canada. Moreover, argues Canada, the term "export credits" is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry. The scope of "export credits", without any further clarification, is infinite. Brazil has failed to specify either the meaning or the scope of its claim. Further, Canada submits that the term "Canada Account" is not limited in any way in Brazil's claim. It is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry. It appears to Canada from the terms of the claim that Brazil is challenging the whole of Canada Account, transactions under which number in the hundreds and vary from tied-aid transactions to insurance products.

Claim 2

7.25 Canada recalls that Claim 2 states:

> Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

7.26 Canada indicates that, in Claim 2, Brazil has failed to identify any treaty provision that Canada is alleged to have violated. It makes no reference to any provision of the WTO Agreements. In the view of Canada, it thus fails to meet the "minimum prerequisite" of Article 6.2.

Claim 5

7.27 Canada recalls that Claim 5 states:

> Export credits, including financing, loan guarantees, or interest rate support by or through the EDC are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.28 Canada makes the same argument in respect of the reference to "export credits" in Claim 5 as in Claim 1, that is, that the reference is extremely broad. Further, Canada considers that "Brazil's reference to 'the EDC' is similarly so broad as to defy definition"[22]. The term "EDC" in this claim, points out Canada, is limited neither to the Air Wisconsin transaction nor the regional aircraft industry. The claim appears to Canada to be an ill-defined attack on the whole of the EDC, a claim that could potentially cover hundreds of clients and many thousands of transactions since 1995.

Claim 7

7.29 Canada recalls that Claim 7 states:

> Export credits and guarantees provided by *Investissement Québec*, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees" are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.30 Canada makes the same argument in respect of the reference to "export credits" in Claim 7 as in Claim 1, that is, that the reference is extremely broad. Further, Canada considers that the reference to "*Investissement Québec*" in Claim 7 is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry.

7.31 In sum, Canada submits that it "does not know the violations Brazil is alleging and the case it has to answer"[23]. In the opinion of Canada, Brazil's violations of the mandatory requirements of Article 6.2 of the DSU prejudice Canada's ability to prepare and present a full defence in this proceeding.

7.32 Canada considers Brazil's "overarching claim" theory an attempt to cure the deficiencies of Brazil's request for the establishment of a panel. Canada points out that Brazil did not request findings that Canada Account, Corporate Account, and *IQ* "as such, as applied, and in individual transactions" constitute prohibited export subsidies.[24] Canada also goes to some length to highlight differences between Brazil's request for establishment and statements in subsequent submissions, differences which, in Canada's view, demonstrate further the failure of Brazil to abide by the requirements of Article 6.2. Specifically, Canada argues that Brazil's request uses all-encompassing language and only in its response to Canada's preliminary submission has Brazil advised Canada that certain measures were not included.

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[22] Submission of Canada Regarding Jurisdictional Issues, para. 51 (Annex B-3).

[23] *Id.*, para. 44.

[24] Response of Canada to Question 5 from the Panel, Responses of Canada to Questions from the Panel Following the First Meeting of the Panel (Annex B-7).

(ii) Brazil

7.33 Brazil considers that its request for the establishment of a panel meets the four criteria set out by the Appellate Body in *Korea – Dairy*, that is, that the request must: (i) be in writing; (ii) indicate whether consultations were held; (iii) identify the specific measures at issue; and (iv) provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly[25].

7.34 Brazil argues that its request identifies the three Canadian programmes at issue and, for them, the specific categories of support subject to its challenge. Further, for Brazil, the request specifically not only covers challenges to these measures as such, but states clearly that it is also a challenge to the measures as applied in, for instance, the Air Wisconsin transaction. With regard to Canada's complaint that Brazil's claims are extremely broad, Brazil considers that it is a Member's prerogative to challenge any measure, no matter how broad, that it considers inconsistent with another Member's WTO obligations.

7.35 Brazil also recalls that it states expressly in paragraphs 1, 5, and 7 of its request for establishment that the measures at issue are prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement.

7.36 Finally, Brazil submits that the "attendant circumstances" in this case demonstrate that Canada's ability to defend itself has not been prejudiced.

(b) Evaluation by the Panel

(i) Claim 1

7.37 We recall that Claim 1 states:

> Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.38 Canada's request for a preliminary ruling in respect of Claim 1 is based on the breadth of the terms "export credits" and "Canada Account" in the request for the establishment of a panel as it relates to the requirements set out in Article 6.2. That provision reads, in relevant part:

> The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

We note that the request for the establishment of a panel was made in writing in the present dispute, and that the request indicates that consultations were held. What the parties disagree on with regard to Claim 1 is whether the request identifies the specific measures at issue, in that Canada considers Claim 1 too broad.

7.39 In *European Communities – Computer Equipment*, the Appellate Body was required to consider the specificity of the US panel request, which referred, *inter alia*, to "all types of LAN [Local Area Network] equipment". In doing so, the Appellate Body stated:

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[25] *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products* ("*Korea – Dairy*"), Report of the Appellate Body, WT/DS98/AB/R, adopted 12 January 2000, para. 120.

> LAN equipment and PCs with multimedia capacity are both generic terms. Whether these terms are sufficiently precise to "identify the specific measure at issue" under Article 6.2 of the DSU depends, in our view, upon whether they satisfy the purposes of the requirements of that provision.
>
> In *European Communities – Bananas*, we stated that:
>
> > It is important that a panel request be sufficiently precise for two reasons: first, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and, second, it informs the defending party and the third parties of the legal basis of the complaint.
>
> The European Communities argues that the lack of precision of the term, LAN equipment, resulted in a violation of its right to due process which is implicit in the DSU. We note, however, that the European Communities does not contest that the term, LAN equipment, is a commercial term which is readily understandable in the trade.[26]

7.40 In applying the analysis of the Appellate Body to this case, we find that the term "export credits", which has a definite meaning and is found in the Illustrative List of Export Subsidies contained in Annex I to the SCM Agreement, is "readily understandable" in the context of a dispute under Article 3.1(a) of the SCM Agreement. The term "export credits" is also explained by the language following the word "including" in Brazil's request for establishment, i. e., the examples set out by Brazil. We note, further, that it is quite clear from Brazil's request for consultations that the measures at issue were limited to Canada's regional aircraft industry[27]. It is therefore difficult, considering these attendant circumstances, to accept that Canada could not know that the terms "export credits" and "Canada Account" were related in particular to the regional aircraft industry.

7.41 With regard to the comparison Canada makes between the language in Brazil's request for establishment and its response to Canada's preliminary submission, it is clear that Article 6.2 imposes certain requirements on the contents of a request for establishment, not on how these contents compare with subsequent articulations of the complainant's claims. We are of the view that such arguments by Canada, while perhaps illustrative, are not legally relevant to any assessment under Article 6.2.

7.42 Thus, in our view, Brazil's request for the establishment of a panel satisfies the requirement under Article 6.2 of the DSU to "identify the specific measures at issue".

7.43 In *European Communities – Computer Equipment*[28], as well as other cases[29], the Appellate Body has considered whether a lack of specificity in a request for the establishment of a panel has prejudiced the respondent. In that regard, we do not accept Canada's assertion that a lack of

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[26] *European Communities – Customs Classification of Certain Computer Equipment*, Report of the Appellate Body, WT/DS62/AB/R-WT/DS67/AB/R-WT/DS68/AB/R, adopted 22 June 1998, paras. 68-70 (footnotes deleted, emphasis added).

[27] WT/DS222/1. (We also note that the title of Brazil's request for establishment, which reads *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, albeit assigned by the WTO Secretariat, was accepted by Brazil.)

[28] *European Communities – Computer Equipment*, Report of the Appellate Body, footnote 26, *supra*, paras. 58-73.

[29] *See Thailand – Anti-dumping Duties on Angles, Shapes, and Sections of Iron or Non-Alloy Steel and H-Beams from Poland*, Report of the Appellate Body, WT/DS122/AB/R, adopted 5 April 2001, paras. 80-97, and *Korea – Dairy*, Report of the Appellate Body, footnote 25, *supra*, paras.114-131.

specificity in Brazil's request for establishment prevented Canada from preparing and presenting a full defence in this proceeding. We note, in this regard, Brazil's statement that, as indicated in its request for establishment, its claims against the EDC Canada Account (and the EDC Corporate Account and *IQ*) are limited to the examples cited therein. Brazil submits that it "has neither asserted any right to expand, nor has it in fact expanded, its claims beyond the specific forms of EDC, Canada Account, and IQ export credits listed in its request for establishment"[30]. Similarly, Brazil's actual claims have been limited to the regional aircraft industry. Thus, given the scope of the claims that Brazil ultimately made in this proceeding, we do not consider that there has been prejudice to the rights of defence of Canada.

7.44 We therefore reject Canada's objection to Claim 1.

(ii) Claim 2

7.45 We recall that Claim 2 states:

> Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

7.46 Canada's request for a preliminary ruling in respect of Claim 2 is based on the lack of reference to a treaty provision in the request for the establishment of a panel as it relates to the requirements set out in Article 6.2 ("a brief summary of the legal basis of the complaint sufficient to present the problem clearly").

7.47 In this regard, we recall that the Appellate Body stated in *Korea – Dairy* that "[i]dentification of the treaty provisions claimed to have been violated by the respondent is *always necessary* both for purposes of defining the terms of reference of a panel and for informing the respondent and the third parties of the claims made by the complainant; such identification is *a minimum prerequisite* if the legal basis of the complaint is to be presented at all"[31]. Further, as noted by the *European Communities – Bed Linen* panel, "[f]ailure to even mention in the request for establishment the treaty Article alleged to have been violated . . . constitutes failure to state a claim at all".[32]

7.48 We further note that Article 7.1 of the DSU – which sets out the standard terms of reference for panels – refers to examination of the matter referred to the DSB "in the light of *the relevant provisions* in (name of the covered agreement(s) . . .)".

7.49 We note that Claim 2 contains no reference at all to a WTO provision and it is therefore clear that even the "minimum prerequisite" of Article 6.2 is not fulfilled. Brazil has not supplied the elements necessary for Claim 2 to fall within our terms of reference. Accordingly, we find that Brazil's Claim 2 does not fall within our terms of reference.

(iii) Claim 5

7.50 We recall that Claim 5 states:

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[30] Response of Brazil to Oral Statement of Canada Regarding Jurisdictional Issues at the First Meeting of the Panel, para. 12 (Annex A-8).

[31] *Korea – Dairy*, footnote 25, *supra*, para. 124 (emphasis added).

[32] *European Communities – Anti-Dumping Measures on Imports of Cotton-Type Bed Linen from India* ("*European Communities – Bed Linen*"), Report of the Panel, WT/DS141/R, adopted 12 March 2001, para. 6.15.

> Export credits, including financing, loan guarantees, or interest rate support by or through the EDC are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.51 Canada's request for a preliminary ruling in respect of Claim 5 is based on the breadth of the terms "export credits" and "EDC" in the request for the establishment of a panel as it relates to the requirements set out in Article 6.2.

7.52 In respect of this preliminary objection, we consider that our analysis of the objection to Claim 1 (*See* paragraphs 7.37-7.44, *supra*) applies here as well. We therefore reject Canada's objection to Claim 5.

(iv) Claim 7

7.53 We recall that Claim 7 states:

> Export credits and guarantees provided by *Investissement Québec*, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees" are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

7.54 Canada's request for a preliminary ruling in respect of Claim 7 is based on the breadth of the terms "export credits" and "*Investissement Québec*" in the request for the establishment of a panel as it relates to the requirements set out in Article 6.2.

7.55 In respect of this preliminary objection, we consider that our analysis of the objection to Claim 1 (*See* paragraphs 7.37-7.44, *supra*) applies here as well. We therefore reject Canada's objection to Claim 7.

C. PROGRAMMES "AS SUCH"

1. Mandatory/discretionary distinction

7.56 We recall that Brazil claims that the EDC Canada and Corporate Accounts and *IQ* are "as such" prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement. Given that Brazil's claims are in respect of the programmes as such, the mandatory/discretionary distinction would traditionally apply. Under that distinction – employed in both GATT and WTO cases over the years[33] – only legislation that requires a violation of GATT/WTO rules could be found to be inconsistent with those rules.

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[33] *See United States – Anti-Dumping Act of 1916*, Report of the Panel, WT/DS136/R-WT/DS162/R, and Report of the Appellate Body, WT/DS136/AB/R-WT/DS162/AB/R, adopted 26 September 2000, *United States – Measures Affecting the Importation, Internal Sale, and Use of Tobacco*, Report of the Panel, BISD 41S/131, adopted 4 October 1994, *Thailand – Restrictions on Importation of and Internal Taxes on Cigarettes*, Report of the Panel, BISD 37S/200, adopted 7 November 1990, *European Economic Community – Regulation on Imports of Parts and Components*, Report of the Panel, BISD 37S/132, adopted 16 May 1990, *United States – Taxes on Petroleum and Certain Imported Substances (Superfund)*, Report of the Panel, BISD 34S/136, adopted 17 June 1987.

We also note the statement of the Appellate Body in *United States – Hot-Rolled Steel* that "[t]he captive production provision does not, by itself, *require* an exclusive focus on the merchant market, nor does it *compel* a selective approach to the analysis of the merchant market that *excludes* an equivalent examination of the captive market. The provision also does not itself *mandate* that particular weight be accorded to data pertaining to the merchant market. Rather, as explained above, the provision allows the USITC to examine the

7.57 In this regard, we recall that the panel in *United States – Export Restraints* stated:

> There is a considerable body of dispute settlement practice under both GATT and WTO standing for the principle that only legislation that *mandates* a violation of GATT/WTO obligations can be found as such to be inconsistent with those obligations. This principle was recently noted and applied by the Appellate Body in *United States – Anti-Dumping Act of 1916* ("*1916 Act*"):
>
> > [T]he 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.
> >
> > . . .
> >
> > [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.[34]

7.58 We note that Brazil expressly "agrees . . . that the distinction between discretionary ('as applied') and mandatory ('as such') legislation is an established principle of GATT and WTO jurisprudence"[35]. There is, therefore, no disagreement between the parties regarding the applicability of the mandatory/discretionary distinction.[36]

7.59 Accordingly, we shall apply the mandatory/discretionary distinction in this dispute in determining whether the Canadian programmes at issue are as such inconsistent with WTO obligations, i. e., whether the legal texts governing the establishment and operation of these programmes are mandatory in respect of the violations alleged by Brazil. In other words, to assess

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merchant market *and* the captive market, with the same degree of care and attention, as part of a broader examination of the domestic industry as a whole . . . Accordingly, if and to the extent that it is interpreted in a manner consistent with our reasoning, as set forth in paragraphs 203 to 208 of this Report, we see no necessary inconsistency between the captive production provision, *on its face*, and the *Anti-Dumping Agreement*" (*United States – Anti-Dumping Measures on Certain Hot-Rolled Steel Products from Japan* ("*United States – Hot-Rolled Steel*"), Report of the Appellate Body, WT/DS184/AB/R, adopted 23 August 2001, para. 208) (footnote omitted, emphasis in original).

[34] *United States – Measures Treating Export Restraints as Subsidies* ("*United States – Export Restraints*"), Report of the Panel, WT/DS194/R, adopted 23 August 2001, para. 8.4 (footnotes omitted).

[35] Response of Brazil to Question 28 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9). We further note that the panels in *Canada – Aircraft* as well as *Brazil – Aircraft* applied the mandatory/discretionary distinction as did the Appellate Body in those cases (*Canada – Aircraft*, Reports of the Panel and the Appellate Body, footnote 9, *supra*, and *Brazil – Export Financing Programme for Aircraft* ("*Brazil – Aircraft*"), Reports of the Panel and the Appellate Body, WT/DS46/R and WT/DS46/AB/R respectively, adopted 20 August 1999). Finally, we note that Brazil argued that the mandatory/discretionary distinction should be applied in *Brazil – Aircraft – Second Article 21.5* (*Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU* ("*Brazil – Aircraft – Second Article 21.5*"), Report of the Panel, WT/DS46/RW/2, adopted 23 August 2001).

[36] We note that the *Section 301* Panel found that even discretionary legislation may violate certain WTO obligations (*See United States – Sections 301-310 of the Trade Act of 1974*, Report of the Panel, WT/DS152/R, adopted 27 January 2000, para. 7.53). We recall that the Panel's analysis in that dispute focused on the nature of the obligations imposed by Article 23.2(a) of the DSU. Neither party has suggested that similar considerations apply in respect of the provisions of the SCM Agreement that Brazil alleges were violated in this dispute.

Brazil's claim against the EDC as such, we must determine whether the EDC programme mandates the grant of prohibited export subsidies in a manner inconsistent with Article 3.1(a) of the SCM Agreement.

7.60 Brazil argues, however, that the mandatory/discretionary distinction should be applied in the "substantive context" of the EDC, i. e., the fact that the EDC is an export credit agency, and that the very purpose of ECAs is to subsidise exports. Brazil explains that its reference to "substantive context" is drawn from the following statement by the panel in *United States – Export Restraints*:

> We are not aware of any GATT/WTO precedent that would require a panel to consider whether legislation is mandatory or discretionary *before* examining the substance of the provisions at issue. To the contrary, we note that a number of panels, in disputes concerning the consistency of legislation, have *not* considered the mandatory/discretionary question in the abstract and as a necessarily threshold issue. Rather, the panels in those cases first resolved any controversy as to the requirements of the GATT/WTO obligations at issue, and only then considered *in light of those findings* whether the defending party had demonstrated adequately that it had sufficient discretion to conform with those rules. That is, the mandatory/discretionary distinction was applied *in a given substantive context*.[37]

7.61 We note, however, that the Panel in that case was primarily addressing the issue of whether the mandatory/discretionary distinction had to be addressed by a panel as a threshold matter as argued by the United States in that case, or whether a panel could address this distinction after considering the legal requirements of the applicable provisions of the WTO Agreement. In other words, the phrase "substantive context" refers to Articles 1 and 3 of the SCM Agreement[38], and not the measure under review. The point made by the panel in *United States – Export Restraints* is simply that it may be difficult to determine whether non-conforming conduct is mandated, without first determining what the obligations are against which conformity is measured. In the present case, the relevant "substantive context" in applying the mandatory/discretionary distinction would be the obligations set forth in Article 3.1(a) of the SCM Agreement, and not the programmes under review.

7.62 We shall therefore apply the mandatory/discretionary distinction in light of Article 3.1(a) of the SCM Agreement. In other words, the question we must address is whether the EDC – the EDC Canada Account and the EDC Corporate Account – or *IQ* requires Canada to provide subsidies contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement.

7.63 We recall that Article 3 of the SCM Agreement states, in relevant part:

> 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, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I; (footnotes deleted)

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[37] *United States – Export Restraints*, footnote 34, *supra*, para. 8.11 (emphasis in original, footnote omitted).

[38] The Panel in *United States – Export Restraints* stated: "[I]dentifying and addressing the relevant WTO obligations first will facilitate our assessment of the manner in which the legislation addresses those obligations, and whether any violation is involved. That is, it is after we have considered both the substance of the claims in respect of WTO provisions and the relevant provisions of the legislation at issue that we will be in the best position to determine whether the legislation requires a treatment of export restraints that violates those provisions" (*United States – Export Restraints*, footnote 34, *supra*, para. 8.12).

7.64 We further recall that Article 1 of the SCM Agreement states:

> 1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
>
> (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
>
> (ii) government revenue that is otherwise due is foregone or not collected (e.g. fiscal incentives such as tax credits [footnote omitted];
>
> (iii) a government provides goods or services other than general infrastructure, or purchases goods;
>
> (iv) a government makes payments to a funding mechanism, or entrusts or directs a private body to carry out one or more of the type of functions illustrated in (i) to (iii) above which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments;
>
> or
>
> (a)(2) there is any form of income or price support in the sense of Article XVI of GATT 1994;
>
> and
>
> (b) a benefit is thereby conferred.

Thus, Article 1.1 makes clear that the definition of a subsidy has two distinct elements (i) a financial contribution (or income or price support), (ii) which confers a benefit.

7.65 Thus, in this case, Brazil would have to demonstrate that the legal instruments governing the establishment and operation of the programmes at issue are mandatory in respect of the alleged violation, i. e., the grant of prohibited export subsidies. In other words, Brazil would have to demonstrate that the legal instruments mandate (i) a financial contribution; (ii) which confers a benefit, and a subsidy therefore exists, and (iii) that subsidy is contingent upon export performance.

7.66 We note that Canada has not contested that the legal instruments governing the programmes at issue mandate financial contributions. We also note that Article 1.1(a)(1)(i) indicates that a financial contribution exists where "a government practice involves a direct transfer of funds (e. g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e. g. loan guarantees)". We consider that there is no disagreement between the parties that the legal instruments governing the programmes at issue mandate such activity.

7.67 We note, however, that the parties do not agree that the legal instruments governing the programmes at issue mandate conferral of a benefit and establish export contingency. We shall address those questions in the context of each programme. With respect to the conferral of a benefit, which we shall address first, we will be guided by the relevant findings of the panel in *Canada – Aircraft*. In that case, the panel found that:

> First, in our opinion the ordinary meaning of "benefit" clearly encompasses some form of advantage. We do not consider that the ordinary meaning of "benefit" *per se* includes any notion of net cost to the government. As Canada itself has noted, the dictionary definition of "benefit" refers to "advantage", and not to net cost. In order to determine whether a financial contribution (in the sense of Article 1.1(a)(i)) confers a "benefit", *i.e.*, an advantage, it is necessary to determine whether the financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution. In our view, the only logical basis for determining the position the recipient would have been in absent the financial contribution is the market. Accordingly, a financial contribution will only confer a "benefit", *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.[39]

Further, the Appellate Body upheld the findings of the panel, ruling as follows:

> We also believe that the word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.[40]

7.68 Thus, we shall now examine whether the legal instruments governing the programmes at issue mandate subsidisation, in particular, the conferral of a benefit within the meaning of Article 1 of the SCM Agreement. If that is the case – and a subsidy therefore exists – we will examine whether that subsidy is contingent upon export performance.

2. Export Development Corporation "as such"

7.69 The EDC is incorporated under the laws of Canada and is wholly owned by the Government of Canada. Canada explains that the EDC operates on commercial principles[41] with the objectives of:

> (a) supporting and developing, directly or indirectly, Canada's export trade; and
>
> (b) supporting and developing, directly or indirectly, Canada's capacity to:
>
> (i) engage in exports, and
>
> (ii) respond to international business opportunities.[42]

7.70 We note that Brazil makes a broad argument in respect of the EDC as such – in terms of the EDC Corporate and Canada Accounts being export credit agencies – which applies to both the EDC Corporate and Canada Accounts. Brazil also makes certain additional arguments which are specific to each of the two accounts. We shall first address the broad argument encompassing both accounts and

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[39] *Canada – Aircraft*, Report of the Panel, footnote 9, *supra*, para. 9.112 (footnote omitted).
[40] *Canada – Aircraft*, Report of the Appellate Body, footnote 9, *supra*, para. 157.
[41] First Written Submission of Canada, para. 19 (Annex B-4).
[42] *Export Development Act*, RSC 1985, c. E-20, s. 10 (Exhibit BRA-17).

then the additional arguments specific to each account, applying the mandatory/discretionary distinction to all three sets of arguments.

(a) Export Development Corporation as an export credit agency

(i) Brazil

7.71 Brazil's broad argument regarding the EDC as such is that the EDC Corporate and Canada Accounts "are established and operate as export credit agencies ["ECAs"] that have as the *raison d'être* of their existence the provision of export subsidies"[43]. Brazil claims that ECAs operate with an unfair competitive advantage, as they are able to raise funds at a lower cost than their private sector competitors, and because they are exempted from certain taxes. Thus, when the EDC provides guarantees, loans, and financial services, it necessarily confers a benefit. The fact that the EDC operates on "commercial principles" does not eliminate this unfair competitive advantage, nor the benefit. Brazil asserts that the safe haven of item (k) of the Illustrative List was created precisely because the provision of prohibited export subsidies is "inherent in the very existence and functioning of an ECA"[44].

7.72 Brazil further claims that specific examples demonstrate that the EDC as such provides prohibited export subsidies in the form of loan guarantees, financial services, and debt financing.

(ii) Canada

7.73 Canada argues that Brazil, by its argument that all ECAs necessarily provide prohibited export subsidies, seeks to escape its burden of proving the existence of a subsidy and, in particular, a benefit. In the opinion of Canada, Brazil's argument is not supported by the text of the SCM Agreement, and it is contrary to what previous panels and the Appellate Body have found to constitute a subsidy. As ECAs vary with respect to legal status, policies, and products, they do not necessarily subsidise exports, according to Canada. Canada considers that the test of whether an ECA offers a subsidy is not "Is it an ECA?", but whether the recipient of the financing receives a financial contribution on terms more favourable than those available to the recipient in the market, as per the finding of the Appellate Body in *Canada – Aircraft*.

7.74 Canada disputes Brazil's attempt to refer to individual transactions to defend its "as such" claim. According to Canada, a Member cannot look to individual transactions to illustrate that a measure is inconsistent as such. To prove that a measure is inconsistent as such, a Member must prove that the executive is legally required to act in a manner inconsistent with the WTO Agreement in some circumstances.

(iii) Findings

7.75 We note that, as is well established in WTO dispute settlement, the initial burden of proof lies on the complaining party, which must establish a prima facie case of inconsistency. The burden then shifts to the defending party, which must counter or refute the claimed inconsistency. We recall, in this regard, the statement of the Appellate Body in *Hormones*:

> The initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency with a particular provision of the *SPS Agreement* on the part of the defending party, or more precisely, of its SPS measure or measures complained

[43] Response of Brazil to Question 29 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9).

[44] *See* footnote 35, *supra*.

> about. When that *prima facie* case is made, the burden of proof moves to the defending party, which must in turn counter or refute the claimed inconsistency.[45]

Thus, in this case, Brazil must demonstrate *prima facie* inconsistency in respect of the EDC.

7.76 We recall that Brazil's broad argument is that the EDC as such provides export subsidies as the EDC Corporate and Canada Accounts "are established and operate as [ECAs] that have as the *raison d'être* of their existence the provision of export subsidies"[46], which would be a violation of Article 3.1(a) of the SCM Agreement. Whatever the reason for the existence of export credit agencies, to prove that the EDC as such provides export subsidies, Brazil would have to establish that to be the case on the basis of the various legal texts regarding the establishment and operation of the EDC (i. e., both its Canada and its Corporate Accounts).

7.77 We consider that, despite the fact that Brazil has the burden of proof, it has not pointed to any specific provision in those legal texts that suggests that these programmes mandate subsidisation, in particular, the conferral of a benefit within the meaning of Article 1 of the SCM Agreement. We have nonetheless examined the various legal texts submitted by Brazil and found nothing that points to mandatory subsidisation on the part of the EDC. We note, in particular, that Article 10 of the *Export Development Act* ("*EDA*")[47], which sets out the purposes and powers of the EDC, does not support Brazil's claim of mandatory subsidisation. Article 10(1), which sets out the purposes of the EDC, states:

> The [EDC] is established for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities.

7.78 Article 10(1.1)of the *EDA*, which sets out the powers of the EDC, enumerates a number of activities that the EDC may engage in, including:

> (a) acquire and dispose of any interest in any property by any means;
>
> (b) enter into any arrangement that has the effect of providing, to any person, any insurance, reinsurance, indemnity or guarantee;
>
> (c) enter into any arrangement that has the effect of extending credit to any person or providing an undertaking to pay money to any person;
>
> (d) take any security interest in any property;
>
> (e) prepare, compile, publish and distribute information and provide consulting services;
>
> (f) procure the incorporation, dissolution or amalgamation of subsidiaries;
>
> (g) acquire and dispose of any interest in any entity by any means;

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[45] *European Communities – Measures Concerning Meat and Meat Products (Hormones)*, Report of the Appellate Body, WT/DS26/AB/R-WT/DS48/AB/R, adopted 13 February 1998, para. 98. See also *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, Report of the Appellate Body, WT/DS33/AB/R, adopted 23 May 1997, p. 14.

[46] *See* footnote 43, *supra*.

[47] *Export Development Act*, footnote 42, *supra*, Article 10(1).

> (h) make any investment and enter into any transaction necessary or desirable for the financial management of the [EDC];
>
> . . .

7.79 None of these provisions, nor any other provisions of the EDA, establish mandatory subsidisation in respect of the EDC. Further, Article 19 indicates that the Board of Directors of the EDC may determine the terms and conditions on which the EDC may exercise any power under the EDA, and we have seen no evidence presented by Brazil in respect of any terms and conditions set by the Board that would suggest the mandatory grant of subsidies.

7.80 Brazil submits that ECAs benefit from a competitive advantage over their private sector competitors (because ECAs do not pay taxes, for example), and this enables them to offer more favourable terms than those available in the private sector. According to Brazil, "not paying taxes is illustrative of, and an essential prerequisite to, an ECA's capability to perform its normal mission – to provide export subsidies"[48]. Brazil also implies that there would be no need for the EDC if it did not provide support on terms more favourable than those available on the market.[49] Whether or not these arguments are factually correct, however, we do not see how they establish mandatory subsidisation. That an entity enjoys certain fiscal advantages does not in and of itself prove that that entity is required to pass on those advantages to its clients in the form of subsidies within the meaning of Article 1 of the SCM Agreement.[50]

7.81 In our opinion, the fact that ECAs may have a competitive advantage that allows them to undercut private sector competitors does not mean that they are necessarily required to do so. Furthermore, although the EDC may have provided subsidies in the form of loan guarantees, financial services or debt financing in specific transactions[51], it does not follow from this that the EDC is required to provide such subsidies.

7.82 We note that Brazil submits that "[i]f an ECA is not covered by the safe haven of item (k), it is providing a prohibited subsidy 'as such' because providing export subsidies, as the Tokyo Round negotiators realised, is inherent in the very existence and functioning of an ECA"[52] . . . "[I]tem (k) allows ECAs to perform their normal function and, at the same time, meet GATT, and now WTO, requirements"[53]. By this, we understand Brazil to be arguing that there would have been no need for item (k) if ECAs did not provide export subsidies. Again, Brazil's argument is predicated on the nature of ECAs, which we do not consider dispositive of the question of mandatory subsidisation. We consider that item (k) sets out the circumstances in which the grant of export credits, *inter alia*, is *per se* deemed to be an export subsidy, and provides one specific exception thereto, otherwise known as the "safe haven" of item (k). The existence of item (k) – including its negotiating history – has no bearing on the question of whether an ECA is mandated to provide subsidies. To accept that because item (k) was negotiated in order to reconcile OECD and WTO rules on export subsidies, it follows that all ECAs are required to grant export subsidies would be to make an assumption for which we see no basis and effectively fail to apply the mandatory/discretionary distinction. The existence of

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[48] Second Written Submission of Brazil, para. 47 (Annex A-10).

[49] *See* Exhibit BRA-54.

[50] Further, to the extent that Brazil might be implying that all ECAs grant prohibited export subsidies, we consider that such an argument blurs the distinction between financial contribution and benefit. That an ECA provides export credits demonstrates the existence of a financial contribution, not the conferral of a benefit thereby.

[51] We are making no findings, however, in this respect at this juncture.

[52] Second Written Submission of Brazil, para. 45 (Annex A-10).

[53] Response of Brazil to Question 28 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9).

item (k) does not eliminate the requirement for a complaining party to prove the mandatory nature of the programme in order to prevail on an "as such" claim.

7.83 Finally, we recall Brazil's further argument that specific examples demonstrate that the EDC as such provides prohibited export subsidies in the form of loan guarantees, financial services, and debt financing. "As such" claims are, however, subject to the mandatory/discretionary distinction and, under that distinction, alleged subsidisation would have to be demonstrated on the basis of the various legal texts regarding the establishment and operation of the EDC. In our view, specific instances of subsidisation therefore do not in and of themselves establish "as such" illegality in respect of an underlying programme.

7.84 Having found that the EDC does not – by virtue of being an ECA – mandate the conferral of a benefit and, hence, subsidisation, we need not, and do not, address the question of export contingency.

7.85 For the foregoing reasons, we reject Brazil's argument that the EDC – by virtue of being an ECA – mandates subsidisation, in particular, the conferral of a benefit within the meaning of Article 1 of the SCM Agreement. We therefore find that the EDC is not – by virtue of being an ECA – inconsistent with Article 3.1(a) of the SCM Agreement.

(b) EDC Canada Account

7.86 Having examined Brazil's broad argument encompassing both accounts, we shall now turn to Brazil's additional arguments specific to each account, first addressing Brazil's additional arguments specific to the EDC Canada Account, and then its additional arguments specific to the EDC Corporate Account. Accordingly, to assess Brazil's claim against the EDC Canada Account as such, we must first determine whether the EDC Canada Account mandates the grant of prohibited export subsidies in a manner inconsistent with Article 3.1(a) of the SCM Agreement.[54]

7.87 We recall that the EDC may undertake and administer financing transactions that it would not otherwise undertake provided that the Government of Canada deems them to be in the national interest. Obligations under such activities are funded by the Government of Canada, and the risk is assumed directly by the Government of Canada. This is the so-called "Canada Account".

(i) Brazil

7.88 Brazil claims that Canada has not disputed that EDC support is *de jure* contingent on export, and therefore focuses on the question of subsidisation.

7.89 Brazil submits that the EDC only uses the EDC Canada Account when the terms of its support would not be consistent with "what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*"[55], and thus could not be provided through the EDC Corporate Account. According to Brazil, the EDC Canada Account support is, therefore, apparently not consistent with what Canada deems to be the market, and thus confers a benefit and constitutes a subsidy. Brazil further asserts that the very existence of the EDC *Canada Account Policy Guideline*[56] demonstrates that EDC Canada Account support as such constitutes a prohibited export subsidy. Brazil indicates that Canada submitted in the *Canada – Aircraft – Article 21.5* case that, under this guideline, "future Canada Account transactions will be consistent with Canada's obligations under the

[54] We note that, pursuant to item (k) of the Illustrative List of Export Subsidies annexed to the SCM Agreement, "an export credit practice which is in conformity with [the interest rate] provisions [of the *OECD Arrangement*] shall not be considered an export subsidy prohibited by this Agreement".

[55] First Written Submission of Canada, para. 67 (emphasis in original) (Annex B-4).

[56] Exhibit CAN-17 and Appendix A to Exhibit CAN-16.

SCM Agreement in that they will qualify for the safe haven in the second paragraph of item (k)"[57]. Brazil points out that the Article 21.5 Panel determined that the Policy Guideline was not sufficient to qualify EDC Canada Account support for the safe haven and, by Canada's own admission, without the protection of the safe haven, EDC Canada Account support constitutes a prohibited export subsidy. For Brazil, "it is the *failure* of the policy guideline . . . that speaks to the nature of EDC's Canada Account 'as such'"[58].

(ii) Canada

7.90 Canada maintains that the EDC Canada Account is discretionary, indicating that the *Canada – Aircraft* Panel found that the programme is discretionary and that there is no reason for the present panel to diverge from this finding. According to Canada, Brazil has not submitted arguments or evidence showing that the *Canada – Aircraft* Panel erred in its findings. Nor, submits Canada, has Brazil offered any basis on which the circumstances giving rise to the *Canada – Aircraft* findings can be distinguished from the circumstances in this dispute.

(iii) Findings

7.91 Again, we note that, as is well established in WTO dispute settlement, the initial burden of proof lies on the complaining party, which must establish a prima facie case of inconsistency. The burden then shifts to the defending party, which must counter or refute the claimed inconsistency. Thus, in this case, Brazil must demonstrate prima facie inconsistency in respect of the EDC Canada Account.

7.92 We recall that the panel in *Canada – Aircraft* rejected Brazil's claim that Canada Account debt financing for the export of Canadian regional aircraft as such constituted an export subsidy inconsistent with Article 3.1(a) of the SCM Agreement.[59] Leaving aside for the moment the issue of

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[57] *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU* ("*Canada – Aircraft – Article 21.5*"), Report of the Panel, WT/DS70/RW, adopted 4 August 2000, para. 5.61.

[58] Response of Brazil to Question 49 from the Panel, Responses of Brazil to Questions from the Panel Prior to the Second Meeting of the Panel (Annex A-11).

[59] *See Canada – Aircraft*, Report of the Panel, footnote 9, *supra*, para. 10.1. See also Section VII.B.1, *supra*. In this regard, we recall, in particular, the statement of the Appellate Body in *Japan – Alcoholic Beverages II* that:

> [a]dopted panel reports are an important part of the GATT *acquis* . . . They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. (*Japan – Taxes on Alcoholic Beverages* ("*Japan – Alcoholic Beverages II*"), Report of the Appellate Body, WT/DS8/AB/R-WT/DS10/AB/R-WT/DS11/AB/R, adopted 1 November 1996, p. 14.)

Noting this passage, the panel in *India – Patents (EC)* stated:

> [P]anels are not *bound* by previous decisions of panels or the Appellate Body even if the subject-matter is the same. In examining dispute WT/DS79 we are not legally bound by the conclusions of the Panel in dispute WT/DS50 as modified by the Appellate Body report. However, in the course of "normal dispute settlement procedures" required under Article 10.4 of the DSU, we will take into account the conclusions and reasoning in the Panel and Appellate Body reports in WT/DS50. Moreover, in our examination, we believe that we should give significant weight to both Article 3.2 of the DSU, which stresses the role of the WTO dispute settlement system in providing security and predictability to the multilateral trading system, and to the need to avoid inconsistent rulings[]. (*India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India – Patents (EC)*"), Report of the Panel, WT/DS79/R, adopted 2 September 1998, para. 7.30 (emphasis in original).)

export contingency, we first address that of subsidisation, in particular, whether Canada Account mandates the conferral of a benefit within the meaning of Article 1 of the SCM Agreement.[60]

7.93 We recall that, under the mandatory/discretionary distinction, Brazil must demonstrate subsidisation on the basis of the legal texts governing the establishment and operation of the EDC Canada Account. We note, however, that the *EDA*[61], which establishes the EDC, does not give any indication of mandatory subsidisation, nor does Brazil argue that it, or any of the other legal texts, does. In particular, the guidelines that apply, including those, such as Appendix A to the *Policy Directive GEN 000-004 – Submission of Documents to the Government of Canada*[62] and the *EDC Canada Account Policy Guideline*[63], adopted to implement the recommendations of the DSB pursuant to *Canada – Aircraft*, refer only to the OECD Arrangement. The *EDC Canada Account Policy Guideline* states: "For the purposes of an authorisation under subsection 23(1) of the *Export Development Act* of a financing transaction or class of financing transactions, it is the policy of the Minister for International Trade to consider that any such transaction or class of transactions which does not comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits would not be in the national interest."[64] None of these guidelines is sufficient to establish mandatory subsidisation with regard to the EDC Canada Account. While it may be true that even when a programme complies with the OECD Arrangement, it may – pursuant to the findings of the panel in *Canada – Aircraft – Article 21.5* – involve the grant of prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement, that is not necessarily the case. In our view, Brazil has pointed to no legal text which demonstrates mandatory subsidisation.

7.94 Brazil argues that the existence of subsidisation, in particular, the conferral of a benefit, in respect of the EDC Canada Account is effectively established by the indication as to the circumstances in which the EDC Canada Account is used, in that the EDC Canada Account is only used when the grant of a subsidy is involved. Brazil's argument – made on the basis of a Canadian statement – is that the EDC Canada Account is used only when the terms of its support would not be consistent with "what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*"[65], and that this indicates that a benefit is conferred. We see no legal basis for this assertion, however, nor does Brazil indicate any. Moreover, the material before us regarding operation of the EDC Canada Account would suggest that the assertion is not factually correct. Export Development Corporation: Annual Report 1999-2000 Reference Guide reads, in relevant part:

> While EDC strives to find ways to structure transactions under its Corporate Account, there are a number of factors which might lead EDC to refer a transaction to Canada Account. The transaction could: exceed EDC's exposure guidelines for a particular country (that is, the maximum amount of business EDC has decided it can prudently undertake in a specific market); involve markets where, for reasons of exceptional risk, EDC is unwilling to support Canadian export business; or it could involve an

[60] We note that, in the present dispute, Brazil claims that Canada has not disputed that EDC support is *de jure* contingent on export, and therefore focuses on the question of subsidisation.

[61] *See* footnote 42, *supra*.

[62] Exhibit CAN-16.

[63] Exhibit CAN-17.

[64] Subsection 23(1) of the *Export Development Act* states: "Where the [EDC] advises the Minister that it will not, without an authorisation made pursuant to this section, enter into any transaction or class of transactions that it has the power to enter into under paragraphs 10(1.1)(a) to (e) or (i) to (k) and the Minister is of the opinion that it is in the national interest that the [EDC] enter into any such transaction or class of transactions, the Minister, with the concurrence of the Minister of Finance, may authorise the [EDC] to do so" (Exhibit BRA-17).

[65] First Written Submission of Canada, para. 67 (emphasis in original) (Annex B-4).

amount or a term in excess of that which EDC would normally undertake for a single borrower.[66]

7.95 It is clear to us from the cited language that there are various factors in a given transaction which might lead to the use of the EDC Canada, rather than Corporate, Account, and these factors serve as limitations on EDC Corporate Account involvement in any particular transaction. We do not see, however, how the conditions for use of the EDC Canada Account demonstrate the existence of mandatory subsidisation, in particular that the programme requires the conferral of a benefit when used to provide financing assistance. We consider that Brazil has failed to demonstrate that EDC Canada Account support necessarily involves subsidisation. Although we can see that such support might conceivably take the form of subsidisation, there is nothing to suggest that this must, in law, be the case.

7.96 Having found that the EDC Canada Account does not mandate the conferral of a benefit and, hence, subsidisation, we need not, and do not, address the question of export contingency.

7.97 For the foregoing reasons, we reject Brazil's claim that the EDC Canada Account mandates the provision of export subsidies contrary to Article 3.1(a) of the SCM Agreement. We therefore find that the EDC Canada Account as such is not inconsistent with Article 3.1(a) of the SCM Agreement.

(c) EDC Corporate Account

7.98 We now turn to Brazil's additional arguments specific to the EDC Corporate Account. To assess Brazil's claim against the EDC Corporate Account, we must determine whether the EDC Corporate Account *per se* mandates the grant of prohibited export subsidies in a manner inconsistent with Article 3.1(a) of the SCM Agreement.

7.99 We recall that EDC "Corporate Account" activities are the EDC's activities on its own account.

(i) Brazil

7.100 Brazil claims that Canada has not disputed that EDC support is *de jure* contingent on export, and therefore focuses on the question of subsidisation.

7.101 Brazil argues that the EDC Corporate Account was established to support exports by providing financial services that the market does not provide. The EDC Corporate Account "complements" the market. It provides interest rates below the CIRR[67] and for terms that exceed ten years. Yet the CIRR and the ten-year repayment term are, in the words of the OECD Arrangement, "the most generous repayment terms and conditions that may be supported". The Appellate Body has concluded that terms more generous than those provided by the OECD Arrangement are positive evidence of a material advantage; such terms are, *a fortiori*, positive evidence of a benefit. The EDC Corporate Account, by its own description, provides financial services to Canadian exporters – and only to Canadian exporters – on terms superior to the terms specified in the OECD Arrangement and superior to those the exporters could obtain elsewhere. Provision of these services is contingent in law upon export. They therefore constitute a prohibited export subsidy.

(ii) Canada

[66] Export Development Corporation: Annual Report 1999-2000 Reference Guide, p. 7 (Exhibit BRA-23).

[67] Commercial Interest Reference Rate within the meaning of Article 15 of the *OECD Arrangement*.

7.102 Canada maintains that the EDC Corporate Account is discretionary, indicating that the *Canada – Aircraft* Panel found that the programme is discretionary and that there is no reason for the present panel to diverge from this finding. According to Canada, Brazil has not submitted arguments or evidence showing that the *Canada – Aircraft* Panel erred in its findings. Nor, submits Canada, has Brazil offered any basis on which the circumstances giving rise to the *Canada – Aircraft* findings can be distinguished from those in this dispute.

7.103 Canada further responds that EDC Corporate Account financing is not offered on terms more favourable than those available in the market. It does not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement and therefore does not amount to a subsidy. As Brazil has failed to show that EDC Corporate Account financing amounts to a subsidy, the issue of export contingency is moot.

7.104 Canada disputes Brazil's attempt to refer to individual transactions to defend its "as such" claim. According to Canada, a Member cannot look to individual transactions to illustrate that a measure is inconsistent as such. To prove that a measure is inconsistent as such, a Member must prove that the executive is legally required to act in a manner inconsistent with the WTO Agreement in some circumstances.

(iii) Findings

7.105 Again, we note that, as is well established in WTO dispute settlement, the initial burden of proof lies on the complaining party, which must establish a prima facie case of inconsistency. The burden then shifts to the defending party, which must counter or refute the claimed inconsistency. Thus, in this case, Brazil must demonstrate *prima facie* inconsistency in respect of the EDC Corporate Account.

7.106 Leaving aside for the moment the issue of export contingency, we first address that of subsidisation, in particular, whether the EDC Corporate Account mandates the conferral of benefit within the meaning of Article 1 of the SCM Agreement.[68]

7.107 We recall that, under the mandatory/discretionary distinction, Brazil must demonstrate subsidisation on the basis of the legal texts governing the establishment and operation of the EDC Corporate Account. To satisfy the "benefit" element of Article 1.1 of the SCM Agreement for purposes of a challenge to the EDC Corporate Account as such, Brazil must show that the programme requires conferral of a benefit, not that it could be used to do so, or even that it is used to do so. We note, however, that Brazil points to no legal text in respect of the EDC Corporate Account as establishing mandatory subsidisation. We note, further, that we have found none. The EDA[69], in particular, which establishes the EDC, does not give any indication of mandatory subsidisation. We also note various other texts[70] submitted by Canada in this regard, in particular, the *Credit Risk Policy Manual*[71] and the *Policy for Implementing Market-Based and Official Support Transactions*[72]. Nothing in these texts provides any evidence to support the mandated conferral of a benefit in financing supplied through the EDC Corporate Account.

7.108 Rather, there is arguably evidence to the contrary which, while not conclusive, suggests that the EDC Corporate Account is not to be used to provide prohibited export subsidies. The *EDC Credit*

[68] We note that Brazil claims that Canada has not disputed that EDC support is *de jure* contingent on export, and therefore focuses on the question of subsidisation.

[69] *See* footnote 42, *supra*.

[70] *See* Exhibits CAN-18-23, 25, 46-47, and 49.

[71] Exhibit CAN-48.

[72] Exhibit CAN-50.

Risk Policy Manual states, for instance: "EDC will establish pricing levels that are appropriate for the underlying credit risk and other relevant considerations applicable to EDC (e. g., Canada's obligations pursuant to the WTO Agreement and the OECD Consensus)."[73] And the *Policy for Implementing Market-Based and Official Support Transactions* states, for instance: "This policy is intended . . . to provide greater certainty of conformity of EDC's medium-/long-term transactions with applicable international trade agreements, primarily the WTO SCM Agreement and the OECD Arrangement, as facts supporting conformity must be adequately documented for each transaction in accordance with the transaction classification process specified herein."[74]

7.109 We recall further that Canada states: "In terms of the pricing process, the EDC's transportation group has a committee that reviews and approves the pricing on all transactions in the civil aircraft sector. In setting this pricing, the EDC compares what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*. The EDC then prices according to that benchmark. In the absence of this benchmark, the EDC compares the relevant borrower to borrowers of comparable credit standing in the civil aviation sector for whom a similar credit history exists; the EDC then prices according to this alternative benchmark."[75] The *EDC Credit Risk Policy Manual* states: "EDC's credit commitments will be priced with respect to market practices"[76]. Again, there is nothing to suggest that EDC Corporate Account support must, in law, confer a benefit, and therefore take the form of subsidisation.

7.110 We also recall that Brazil submits that operating on commercial principles does not exclude subsidisation, since certain EDC services / products are not available on the market. According to Brazil, the provision by the EDC Corporate Account of services not available on the market necessarily means that services are provided on terms more favourable than those available on the market. As an example, Brazil refers to the EDC Corporate Account's "ability" to complement the services of banks and other financial institutions. We recall, however, that our terms of reference limit the scope of our enquiries to the universe of export credits. To the extent that any services provided by the EDC Corporate Account are independent of export credits provided by the EDC Corporate Account, we consider that those services are not measures that fall within our terms of reference. To the extent that any such services are part and parcel of export credits provided by the EDC Corporate Account, those services fall within our terms of reference and are part of our assessment of export credits provided by the EDC Corporate Account. In this regard, we consider that any such services could not constitute a financial contribution independently of the export credits in relation to which they are provided.

7.111 Even assuming that the provision of services not available on the market necessarily confers a benefit, the fact that the EDC Corporate Account has the "ability" to provide such services does not necessarily mean that it is required to do so. As noted above, to satisfy the "benefit" element of Article 1.1 of the SCM Agreement for purposes of a challenge to the EDC Corporate Account as such,

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[73] *See* footnote 71, *supra*, p. 16. With regard to the legal status of the EDC Credit Risk Policy Manual, we note Canada's statement as follows: "As a self-governing, autonomous Crown corporation, EDC's operating practices and policies are the responsibility of its Board of Directors. The Credit Risk Policy Manual was approved by the Board of Directors, but it is not legislation and consequently is not binding on EDC in the same way as legislation would be. However, any transaction of EDC which is within the authority delegated to EDC management and which departs from the policies in the Manual is not duly authorised unless the transaction is in accordance with an exception to the relevant policy (as approved by the Board of Directors) or the Board approves the transaction itself" (Response of Canada to Question 63 from the Panel, Responses of Canada to Questions from the Panel Following the Second Meeting of the Panel (Annex B-11)).

[74] See footnote 72, *supra*.

[75] First Written Submission of Canada, para. 67 (Annex B-4).

[76] *See* footnote 73, *supra*.

Brazil would have to show that the programme requires conferral of a benefit, not that it could be used to do so, or even that it is used to do so.[77]

7.112 Having found that the EDC Corporate Account does not mandate the conferral of a benefit and, hence, subsidisation, we need not, and do not, address the question of export contingency.

7.113 For the foregoing reasons, we reject Brazil's claim that the EDC Corporate Account mandates the provision of export subsidies contrary to Article 3.1(a) of the SCM Agreement. We therefore find that the EDC Corporate Account as such is not inconsistent with Article 3.1(a) of the SCM Agreement.

3. *Investissement Québec* "as such"

7.114 Having examined Brazil's claim against the EDC as such, we shall now turn to Brazil's claim against *IQ* as such. Accordingly, to assess Brazil's claim against *IQ* as such, we must first determine whether *IQ* mandates the grant of prohibited export subsidies in a manner inconsistent with Article 3.1(a) of the SCM Agreement.

(i) Brazil

7.115 Brazil asserts that *IQ* constitutes a prohibited export subsidy as such. In respect of mandatory subsidisation, Brazil submits that *IQ* is mandated to provide assistance under Section 28 of the *IQ Act*. Brazil argues that a benefit is necessarily conferred when such assistance takes the form of loan guarantees, because firms buying Bombardier aircraft benefit from the superior credit rating of the Government of Québec. *IQ* equity guarantees also confer a benefit, as a governmental guarantee is provided to equity investors. In response to Canada's defence that fees have been charged for such guarantees, Brazil asserts that Canada has failed to demonstrate that the fees charged by *IQ* are commensurate with those charged by commercial guarantors with A+ or A2 credit ratings to firms wishing to enjoy the benefits of those guarantors' A+ or A2 ratings.

7.116 Brazil notes that, furthermore, the latest decree[78], issued in 2000 to replenish the *IQ* guarantee fund for the Air Wisconsin transaction, eliminates the requirement that fees be charged. Brazil further notes that Canada still argues that fees are in fact charged. In this regard, Canada relies on paragraph B of the *IQ* criteria[79] which requires that "*IQ* will not make support available for transactions if the remuneration it is to receive is less than that offered in the market". Brazil submits, however, that a closer look at paragraph B demonstrates otherwise; according to paragraph B, if the "competitive nature" of the transactions requires that *IQ* receive less than it would in the market, it will do so.

7.117 In respect of mandatory export contingency, Brazil asserts that *IQ* support is – on the basis of Decrees 572-2000 and 841-2000 – *de jure* contingent on the export of goods outside of Québec. Brazil submits that contingency on export outside Québec should be sufficient to find export contingency within the meaning of Article 3.1(a), or else Members would be able to subvert the

[77] This is not a case where EDC Corporate Account support necessarily confers a benefit, and where the only discretion available is that of not providing the support 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 Canada has discretion to operate the EDC Corporate Account 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 Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*, Report of the Appellate Body, WT/DS56/AB/R, adopted 22 April 1998, paras. 49 and 54.)

[78] Decree 1488-2000 (Exhibit CAN-36).

[79] Exhibit CAN-51.

SCM Agreement export subsidy disciplines by introducing subsidy programmes that exclude small parts of their home territories.

(ii) Canada

7.118 Canada submits that Section 28 of the *IQ Act* provides "the executive authority" with complete discretion regarding the terms and conditions of the assistance it provides. Canada asserts that *IQ* assistance in regional aircraft transactions is authorised more specifically under certain Decrees, which empower *IQ* to grant guarantees or counter-guarantees up to certain amounts of money. *IQ* enjoys complete discretion under these decrees. Furthermore, by virtue of *IQ*'s transaction evaluation criteria[80], *IQ* must provide support on market terms. *IQ* therefore cannot mandate the provision of subsidies.

7.119 In respect of export contingency, Canada denies that Decree 572-2000, which conditions assistance on export outside of Québec, has anything to do with aircraft sales financing. Nor does it preclude funding for projects within Québec. In any event, Canada submits that contingency on export outside of Québec does not fall within the scope of the Article 3.1(a) prohibition. "Exportation" within the meaning of the SCM Agreement refers to the movement of goods and services between Members, not within them.

(iii) Findings

7.120 We note that, as is well established in WTO dispute settlement, the initial burden of proof lies on the complaining party, which must establish a prima facie case of inconsistency. The burden then shifts to the defending party, which must counter or refute the claimed inconsistency. Thus, in this case, Brazil must demonstrate prima facie inconsistency in respect of *IQ*.

7.121 Leaving aside for the moment the issue of export contingency, we first address the issue of subsidisation, in particular, whether *IQ* mandates the conferral of a benefit within the meaning of Article 1 of the SCM Agreement.

7.122 We recall that Brazil's claim is based on provisions of the *IQ Act* and Decrees 572-2000 and 841-2000. Canada asserts, however, that the Decrees "have nothing to do with aircraft sales financing and are not used for aircraft sales financing"[81]. In response, Brazil notes that the Decrees relate to support for the sale of goods, and asserts that because regional aircraft are goods, support for the sale of regional aircraft is covered by the Decrees. Canada responds that "Decree 841-2000 could not apply to financing of Bombardier regional aircraft because it applies only to small enterprises. Decree 572-2000 applies, for the most part, to investments in Québec. However, one of the measures in the Decree provides for loan guarantees intended for buyers outside of Québec for the purchase of goods and services . . . Theoretically, this measure could be used to finance the sale of Bombardier regional aircraft. However, due to [a] Québec content limitation and other restrictions, Decree 572-2000 is not well suited to financing regional aircraft sales and has never been used to do so"[82]. Brazil rebuts these arguments by submitting that nothing in Decree 841-2000 suggests that its application is restricted to small enterprises, adding that there are provisions of the Decree suggesting that it is not restricted to small enterprises.

7.123 To the extent that the Decrees could cover support for the sale of regional aircraft, however, the question we must address is whether such support involves mandatory subsidisation, in particular,

[80] Exhibit CAN-51.
[81] First Written Submission of Canada, para. 93 (Annex B-4).
[82] Response of Canada to Question 69 from the Panel, Responses of Canada to Questions from the Panel Following the Second Meeting of the Panel (Annex B-11).

the conferral of a benefit within the meaning of Article 1 of the SCM Agreement. Brazil does not indicate anything in the *IQ Act*[83] or in Decrees 572-2000[84] and 841-2000[85] that demonstrates necessary subsidisation. Nor have we found any such evidence in these or any other legal texts governing the establishment and operation of *IQ*. We note, in this regard, that Section 28 of the *IQ Act*, which establishes *IQ*, states: "The Government may, where a project is of major economic significance for Québec, mandate the agency to grant and administer the assistance determined by the Government to facilitate the realisation of the project. The mandate may authorise the agency to fix the terms and conditions of the assistance." While Brazil is correct in stating that *IQ* is mandated to provide assistance under Section 28 of the *IQ Act*, nothing in the *IQ Act* suggests that such assistance must take the form of subsidisation, and, in particular, confer a benefit under the SCM Agreement. Rather, *IQ* would seem to have the discretion to determine the terms and conditions of such assistance. Even assuming that *IQ* loan and equity guarantees confer a benefit, the fact that *IQ* may do so does not necessarily mean that it is required to do so. To satisfy the "benefit" element of Article 1 of the SCM Agreement for purposes of a challenge to *IQ* as such, Brazil would have to show, as for purposes of a challenge to the EDC, that the programme requires conferral of a benefit, not that it could be used to do so, or even that it is used to do so.

7.124 Similarly, while Decree 572-2000 enables *IQ* to provide financial support for investment or export projects, and Decree 841-2000 enables *IQ* to provide support for market development projects, nothing in these Decrees demonstrates that that support must take the form of subsidisation. To the contrary, it seems to us that both Decrees allow for the provision of support in other forms and reflect a certain discretion on the part of the agency in respect of the manner in which it undertakes investment or export projects or market development projects, respectively.

7.125 Further, when requested by the Panel to "provide any general or sector-specific regulations, guidelines, policies or similar documents . . . concerning the fixing of the terms and conditions of *IQ* support to the regional aircraft industry"[86], Canada submitted the "*critères d'évaluation des transactions*" (criteria for the evaluation of transactions)[87] which are used by the *IQ* Credit Committee in making its recommendations in respect of particular transactions[88]. Nor do these "*critères*" provide any evidence of mandatory subsidisation. In this regard, we note Canada's further statement that, "subject to the 'critères d'évaluation', *IQ* has very broad discretion in deciding whether to provide such support, and the terms and conditions on which it does so"[89]. In our view, Brazil has failed to establish the contrary to be the case in that it has not identified a legal instrument from which it can be demonstrated that *IQ* involves the mandatory grant of subsidies.

7.126 Having found that *IQ* does not mandate the conferral of a benefit and, hence, subsidisation, we need not, and do not, address the question of export contingency.

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[83] Exhibit BRA-18.
[84] Exhibit BRA-19.
[85] Exhibit BRA-20.
[86] Question 17 from the Panel, Responses of Canada to Questions from the Panel Following the First Meeting of the Panel (Annex B-7).
[87] Exhibit CAN-51.
[88] While we note Canada's statement that "the 'critères' do not fix terms and conditions", we also note its statement that "[n]o other guidelines etc. exist fixing the terms and conditions of *IQ* support to the regional aircraft industry . . . [T]here is no updated version of the 'critères d'évaluation'. They have remained the same since IQ superseded SDI in 1998" (Response of Canada to Question 42 from the Panel, Responses of Canada to Questions from the Panel Prior to the Second Meeting of the Panel (Annex B-9)).
[89] Response of Canada to Question 42 from the Panel, Responses of Canada to Questions from the Panel Prior to the Second Meeting of the Panel (Annex B-9).

7.127 For the foregoing reasons, we reject Brazil's claim that *IQ* mandates the provision of export subsidies contrary to Article 3.1(a) of the SCM Agreement. We therefore find that *IQ* as such is not inconsistent with Article 3.1(a) of the SCM Agreement.

D. EDC / *IQ* "AS APPLIED"

7.128 Brazil requests "that the Panel find the Canada Account, EDC and *IQ* programmes inconsistent with Canada's obligations under the SCM Agreement as applied on the basis of evidence regarding specific transactions".[90]

7.129 Canada asserts that a challenge "as applied" is the same thing as a challenge to "specific transactions".[91]

7.130 In our view, there are a number of reasons why it would not be appropriate for us to make separate findings regarding the EDC and *IQ* programmes "as applied". *First*, we do not consider that Brazil's "as applied" claims are independent of its claims regarding "specific transactions". Indeed, Brazil itself acknowledges that "[i]n order for Brazil to prevail on its 'as applied' claims, the Panel must find that the challenged programmes have been *applied in specific transactions* in a manner that is inconsistent with the SCM Agreement".[92] Since Brazil's "as applied" claims are not independent of its claims against "specific transactions", and since we make findings regarding "specific transactions", we see no practical purpose in making "as applied" findings.

7.131 *Second*, we are unclear as to what the implications of a finding that a programme "as applied" is inconsistent with Article 3.1(a) of the SCM Agreement would be, particularly in the context of implementation. One possibility is that a panel might find that a programme "as applied" is inconsistent with Article 3.1(a) on the basis of findings that all "specific transactions" undertaken thus far under that programme are inconsistent with Article 3.1(a). In such a case, we fail to see what the value added in making a finding regarding the programme "as applied" would be, since the implications for implementation would not extend beyond those "specific transactions". At most, the implication would be that, in the future, the relevant Member should cease to exercise its discretion in a manner inconsistent with Article 3.1(a). This would add nothing to the basic requirement of Article 3.1(a) itself. Another possibility is that a panel might find that a programme "as applied" is inconsistent on the basis of findings that certain – but not all – "specific transactions" under that programme are inconsistent.[93] In this case, the implications for implementation would extend beyond the "specific transactions" in respect of which the panel has made findings. We consider, however, that it would be inappropriate for a panel to extend its findings in this manner.[94]

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[90] Response of Brazil to Question 25 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9). *See* footnote 14, *supra*.

[91] *See* Second Written Submission of Canada, paras. 48-52 (Annex B-8).

[92] *See* Response of Brazil to Question 60 from the Panel (emphasis in original), Responses of Brazil to Questions from the Panel Following the Second Meeting of the Panel (Annex A-14).

[93] We wish to clarify that we are not addressing the situation where a Member's discretionary legislation has functionally become mandatory as a result of that Member exercising its discretion under that legislation in such a manner that it has become legally bound to continue to exercise its discretion in that manner in the future.

[94] To the extent that implementation of an "as applied" finding would imply that a Member must ensure against future exercises of discretion in violation of the SCM Agreement, we recall that the Appellate Body expressed some doubts about such a standard when it noted in *Canada – Aircraft – Article 21.5* that "[t]he use in this standard of 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 … programme. A standard which, if so read, would, however, 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

7.132 *Third*, we recall our earlier remarks regarding the application of the mandatory / discretionary distinction.[95] Further, we recall the statement of the panel in *United States – Export Restraints* that "the distinction between mandatory and discretionary legislation has a rational objective in ensuring predictability of conditions for trade. It allows parties to challenge measures that will necessarily result in action inconsistent with GATT/WTO obligations, *before* such action is actually taken"[96]. The conclusion by a panel that a programme is discretionary and therefore is not inconsistent with the WTO Agreement and a subsequent conclusion, by the same panel, that the programme "as applied" (i.e., the manner in which the discretion inherent in that programme has been applied) is inconsistent with the WTO Agreement would be of little value. In our view, findings regarding a programme "as applied" would undermine the utility of the mandatory / discretionary distinction.

7.133 For these reasons, we reject Brazil's claims regarding the EDC and *IQ* programmes "as applied".

E. INFORMATION GATHERING BY THE PANEL

7.134 In a letter dated 21 May 2001, Brazil asked the panel to exercise its discretion under Article 13.1 of the DSU "to request from Canada documents and other information concerning the terms of any support from 1 January 1995 onward committed or granted by the Export Development Corporation ("EDC"), Canada Account, Investissement Québec ("IQ"), or any subsidiary organizations thereof, in connection with the sale of regional aircraft by Bombardier"[97]. This letter was received prior to the deadlines for the parties' first written submissions. On 12 June 2001, we informed the parties that we do "not consider it appropriate to seek any documents or information from either party until it has at least had an opportunity to review both parties' first written submissions".

7.135 Having reviewed the parties' first written submissions, on 20 June 2001 the Panel asked Brazil "to provide full details of the terms and conditions of Embraer's offer of financing to Air Wisconsin", and Canada "to provide full details of the terms and conditions of its Air Wisconsin transaction". Both parties responded to this request on 25 June 2001. Canada failed to provide a copy of the information to Brazil on that date. Instead, Canada "ask[ed] the Panel to require that when this information is provided to Brazil, its disclosure be restricted to officials of the Government of Brazil and private legal counsel retained and paid for by the Government of Brazil who are directly involved in this dispute settlement proceeding". In a letter to Canada dated 26 June 2001, the Panel noted that Canada's letter of 25 June 2001 "was not copied to Brazil, contrary to paragraph 10 of the Panel's Working Procedures". The Panel further "note[d] that, with the limited exception of paragraph 16, its Working Procedures do not provide for any special procedures regarding the treatment of business confidential information. The Panel does not consider it appropriate to introduce such procedures under the present circumstances, i.e., on the basis of an ex parte request, and without an opportunity to consult with Brazil". For those reasons, the Panel returned Canada's submission of 25 June 2001. At the first substantive meeting, Canada informed the Panel that it had not intended to make an ex parte communication, and that it was not seeking to introduce any special procedures for the treatment of business confidential information. On that basis, its letter of 25 June 2001 was entered in the record.

7.136 During the course of these proceedings, we also addressed a number of additional requests for information and / or documentation to Canada. Since we are not a commission of enquiry, we did not

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compliance measure" (*Canada – Aircraft – Article 21.5*, Report of the Appellate Body, footnote 57, *supra*, para. 38) (emphasis in original).

[95] *See* paras. 7.56-7.57, *supra*.

[96] *United States – Export Restraints*, Report of the Panel, footnote 34, *supra*, para. 8.9 (emphasis in original).

[97] Communication of 21 May 2001 from Brazil to the Panel (Annex A-2).

consider it appropriate to seek additional information and / or documentation on the basis of Brazil's general request of 21 May 2001. We only considered it appropriate to seek additional information / documentation from Canada on the basis of specific information and / or arguments submitted by Brazil.

F. CANADA ACCOUNT SUPPORT FOR THE AIR WISCONSIN TRANSACTION

7.137 On 10 May 2001, the EDC offered Canada Account financing for the acquisition by Air Wisconsin Airlines Corporation ("Air Wisconsin") of [] Bombardier regional jets. The financing will involve [].[98] [].

7.138 Brazil claims that the Canada Account financing to Air Wisconsin constitutes a prohibited export subsidy, contrary to Article 3.1(a) of the SCM Agreement. Canada asserts that the Canada Account financing to Air Wisconsin falls within the scope of the safe haven provided for in the second paragraph of item (k) of Annex 1 of the SCM Agreement.

7.139 In order to establish that the Canada Account financing to Air Wisconsin constitutes a prohibited export subsidy, Brazil must demonstrate[99] that the Canada Account financing constitutes a "financial contribution" that confers a "benefit", within the meaning of Article 1.1 of the SCM Agreement. Brazil must also demonstrate that the Canada Account financing is "contingent … upon export performance", within the meaning of Article 3.1(a) of the SCM Agreement. However, even if Brazil succeeds in establishing that the Canada Account financing to Air Wisconsin is an export subsidy, we will be precluded from finding that it constitutes a prohibited export subsidy if Canada demonstrates[100] that it falls within the second paragraph of item (k) of the Illustrative List of Export Subsidies set forth in Annex 1 of the SCM Agreement.

1. Is the Canada Account financing to Air Wisconsin an export subsidy?

7.140 We shall first consider whether Brazil has established that the Canada Account offer to Air Wisconsin is a "subsidy", i.e., whether it is a "financial contribution" that confers a "benefit". If so, we shall then consider whether Brazil has established that the subsidy is "contingent … upon export performance".

(a) Financial contribution

7.141 Brazil asserts that the Canada Account financing to Air Wisconsin is a "financial contribution" because "Minister Tobin stated that it would take the form of a 'loan', which constitutes a direct or potential direct transfer of funds, within the meaning of Article 1.1(a)1(i)".[101] Canada does not deny that the Canada Account financing to Air Wisconsin constitutes a "financial contribution".

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[98] *See* attachment to communication of 25 June 2001 from Canada.

[99] It is now well established that the initial burden lies on the complaining party, which must establish a prima facie case of inconsistency. The burden then shifts to the defending party, which must counter or refute the claimed inconsistency (*See European Communities – Measures Concerning Meat and Meat Products (Hormones)*, Report of the Appellate Body, WT/DS26/AB/R-WT/DS48/AB/R, adopted 13 February 1998, para. 98).

[100] In our view, the second paragraph of item (k) is available as an exception to the prohibition against export subsidies contained in Article 3.1(a) of the SCM Agreement. Accordingly, the second paragraph of item (k) may be invoked by Canada as an affirmative defence to a claim of violation of Article 3.1(a). In this context, we refer to the second paragraph of item (k) as a "safe haven". As is clear from relevant WTO jurisprudence, the burden of establishing an affirmative defence rests with the party raising it (*See*, for example, *Brazil – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 55).

[101] First Written Submission of Brazil, para. 78 (Annex A-3).

7.142 We note that the Canada Account financing to Air Wisconsin will involve [].[102] [] and is therefore a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement.[103]

(b) Benefit

7.143 Brazil's claim of "benefit" is based on two statements made by Minister Tobin, Canada's Industry Minister, while announcing the Canada Account financing to Air Wisconsin.[104] Minister Tobin stated that Canada is providing Air Wisconsin with "a better rate than one would normally get on a commercial lending basis".[105] Minister Tobin also stated that Canada was in this instance "using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier".[106]

7.144 We recall that a "benefit" is conferred when a recipient receives a "financial contribution" on terms more favourable than those available to the recipient in the market.[107] In our view, Minister Tobin's statements indicate that the Canada Account financing to Air Wisconsin, which will take the form of a loan, will confer a "benefit" because it will be on terms more favourable than those available to the recipient in the market. This is confirmed by the fact that, in these proceedings, Canada itself initially considered the terms of the Canada Account financing to Air Wisconsin to be more favourable than those available in the market[108] (and therefore sought to rely on the item (k) safe haven).

7.145 During the course of these proceedings, however, Canada asserted that the Canada Account financing to Air Wisconsin did not confer a "benefit" because it is no more favourable than financing available to Air Wisconsin on the market, in the form of an offer from Embraer. Canada asserts that the Embraer offer is an appropriate market benchmark against which to measure the Canada Account financing, because []. In other words, Canada assumes that because [], it should necessarily be treated as a market offer.

7.146 In these proceedings, Brazil

> "[]."[109]

7.147 Given the principle of good faith, we accept Brazil's assertion that []. However, that does not mean that Embraer's offer should be treated as a market offer. In this regard, we note *first* that []. Brazil does not deny that these statements were made.

7.148 *Second*, []. In this regard, we note that Embraer has had frequent recourse to PROEX / BNDES support in the past. According to Brazil, approximately [] per cent of Embraer's export sales

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[102] *See* attachment to communication of 25 June 2001 from Canada. [].

[103] Brazil also argues that such a loan would also constitute the provision of a "service[] other than general infrastructure", within the meaning of Article 1.1(a)(1)(iii). In light of our finding under Article 1.1(a)(1)(i), we do not consider it necessary to examine Brazil's argument regarding Article 1.1(a)(1)(iii).

[104] *See* First Written Submission of Brazil, para. 79 (Annex A-3).

[105] *See* Transcript of Press Conference of Industry Minister Tobin, 10 January 2001, para. 66 (Exhibit BRA-21).

[106] *Id.*, para. 20.

[107] *See Canada – Aircraft*, Report of the Appellate Body, footnote 9, *supra*, para. 157.

[108] *See* Response of Canada to Question 10 from the Panel, Responses of Canada to Questions from the Panel Following the First Meeting of the Panel (Annex B-7).

[109] *See* Response of Brazil to Question 32 from the Panel, Responses of Brazil to Questions from the Panel Following the First Meeting of the Panel (Annex A-9).

of regional jets have involved either BNDES or PROEX support.[110] (Canada claims the percentage is much higher).[111] Similarly, Embraer has reported that "[t]he Brazilian government has been an *important source* of export financing for our customers through the BNDES-*exim* program, administered by BNDES. In addition, Banco do Brasil S.A., which is owned by the Brazilian government, administers the ProEx program, which enables some of our customers to receive the benefit of interest discounts."[112] For the reasons in these two paragraphs, we consider that the Embraer offer was made with the expectation of support from the Brazilian Government.

7.149 Furthermore, we recall that Canada itself initially considered the Embraer offer to be below market,[113] and that it restated this view towards the end of these proceedings on 8 August 2001, when it asserted that "it is simply not credible that third-party institutions would provide financing for a relatively low quality credit such as Air Wisconsin []."[114] We also note Brazil's assertion that the terms of Embraer's offer do not constitute the "market".[115] At various stages during these proceedings, therefore, both parties have asserted that the Embraer offer was not a "market" offer. For these reasons, we are unable to find that Embraer made a "market" offer to Air Wisconsin (despite the absence of Brazilian Government official support for that offer).[116] We are therefore obliged to reject Canada's argument that the Canada Account financing to Air Wisconsin did not confer a "benefit" because it was no more favourable than Embraer's "market" offer.

7.150 In view of the statements made by Minister Tobin upon the announcement of the Canada Account financing to Air Wisconsin, and our view that Embraer's offer was not a "market" offer, we find that the Canada Account financing to Air Wisconsin confers a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

(c) Export contingency

7.151 Brazil asserts that the Canada Account financing to Air Wisconsin is "contingent … upon export performance" (Article 3.1(a) of the SCM Agreement) because "[t]he Canada Account is used to support export transactions"[117], and because Canada Account is one way for the EDC to satisfy its

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[110] *See* Response of Brazil to Panel Question 58 from the Panel, Responses of Brazil to Questions from the Panel Following the Second Meeting of the Panel (Annex A-14).

[111] Canada has expressed "considerable reservations regarding the accuracy of Brazil's response" (*See* Comments of Canada on Responses of Brazil to Questions from the Panel Following the Second Meeting of the Panel, paras. 15-19 (Annex B-14)). According to Canada, Brazil has understated the proportion of Embraer's export sales of regional jets that have involved either BNDES or PROEX support. We do not consider it necessary to address this difference of views between the parties, as Brazil's statement that approximately [] per cent of Embraer's export sales of regional jets have involved either BNDES or PROEX support is sufficient for us to conclude that Embraer has had frequent recourse to PROEX / BNDES support in the past.

[112] Embraer, Securities and Exchange Commission Form 20F-2000, p. 75 (emphasis added) (Exhibit CAN-67).

[113] At para. 46 of its first written submission, Canada referred to "Brazil's below-market financing offer to Air Wisconsin" (Annex B-4). In its notification under the *OECD Arrangement*, Canada stated that "[t]he interest rate [offered by Embraer] is substantially lower than the market rate at which a regional airline like Air Wisconsin could borrow" (*See* Exhibit CAN-52, Section 9).

[114] *See* Response of Canada to Question 67 from the Panel, Responses of Canada to Questions from the Panel Following the Second Meeting of the Panel (Annex B-11).

[115] *See* Second Written Submission of Brazil, paras. 105-106 (Annex A-10).

[116] Accordingly, it is not necessary for us to consider whether or not the Canada Account offer to Air Wisconsin was less favourable than Embraer's offer, as alleged by Canada.

[117] Brazil cites language from the EDC's website, "How We Work" (Exhibit BRA-16).

"mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities"[118].

7.152 In addressing Brazil's claim of export contingency, we note *first* that Canada does not deny that the Canada Account financing to Air Wisconsin is "contingent … upon export performance". *Second*, we note that Canada itself has stated that the mandate of the Canada Account is "to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities"[119]. *Third*, we recall that the EDC, which operates the Canada Account programme, was "established for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[120] We therefore consider that any financing provided by the EDC under the Canada Account is necessarily "contingent … upon export performance", since anything the EDC does is statutorily for the purpose of "supporting and developing … Canada's export trade"[121]. *Fourth*, we note that the *Canada – Aircraft* panel found that the Canada Account debt financing at issue in that case was "contingent … upon export performance".[122] For these reasons, we find that support provided under the Canada Account programme, including the financing to Air Wisconsin, is "contingent in law … upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

(d) Conclusion

7.153 In light of the above considerations, we conclude that the Canada Account financing to Air Wisconsin is an export subsidy. As such, the Canada Account financing will constitute a prohibited export subsidy unless it falls within the scope of the item (k) safe haven.

2. Does the Canada Account financing to Air Wisconsin fall within the item (k) safe haven?

(a) Arguments of the parties

7.154 Canada submits that the Canada Account support to Air Wisconsin falls within the safe haven provided for in the second paragraph of item (k), because it is "in conformity with" the "interest rates provisions" of the *OECD Arrangement*.

7.155 According to Canada, it learned in late October 2000 that Brazil was prepared to finance the sale of Embraer regional jets to Air Wisconsin "on below-market terms".[123] The information indicated that Brazil was offering []. Canada considered that it had no choice but to offer Air Wisconsin debt financing on a matching basis. Therefore, Canada offered []. As a pre-condition to the financing, Canada required Air Wisconsin to confirm in writing that Canada's offer was valued by Air Wisconsin as no more favourable, viewed in its entirety, than that offered by Brazil. Air Wisconsin provided such written confirmation on 20 March 2001.

7.156 Canada asserts that the Air Wisconsin transaction is consistent with Canada's SCM Agreement obligations because Canada is merely matching Brazil's offer in a manner consistent with the "interest rates provisions" of the *OECD Arrangement*. Canada's financing on a matching basis thus falls within the exception of the second paragraph of Item (k) in Annex I to the SCM Agreement. In Canada's view, matching in the context of the *OECD Arrangement* qualifies for

[118] Brazil refers to an Industry Canada News Release, dated 10 January 2001, concerning, *inter alia*, the sale of Bombardier aircraft to Air Wisconsin (Exhibit BRA-3).
[119] Industry Canada News Release, 10 January 2001 (Exhibit BRA-3).
[120] *Export Development Act*, footnote 42, *supra*, Section 10(1).
[121] *Id.*
[122] See *Canada – Aircraft*, Report of the Panel, footnote 9, *supra*, para. 9.230.
[123] First Written Submission of Canada, para. 43 (Annex B-4).

the "safe haven" because the matching provisions of the *OECD Arrangement*, i.e., Article 29 of the main text and Articles 25 and 31 of Annex III, are in "conformity" with the "interest rates provisions" and indeed are themselves "interest rates provisions." A body of disciplines on matching has been developed in the *OECD Arrangement* in order to "govern" this practice. In particular, Articles 50 through 53 of the main text set out matching procedures. The mere existence of this body of disciplines demonstrates that matching is a legitimate exercise that is permitted by, and conforms to, the *OECD Arrangement*.

7.157 According to Brazil, recourse to the matching provisions of the *OECD Arrangement* does not constitute "conformity with" the "interest rate provisions" of the *OECD Arrangement*. The ordinary meaning of item (k), in its context, along with the object and purpose of the SCM Agreement, supports this interpretation. Furthermore, in Brazil's view Canada failed to respect the provisions of Article 53 of the *OECD Arrangement*, which imposes certain procedural requirements on Participants seeking to match.[124] Thus, even if matching a derogation could benefit from the item (k) safe haven in principle, Brazil considers that Canada's failure to respect the Article 53 procedural requirements would exclude the item (k) safe haven in this case.

(b) Evaluation by the Panel

7.158 As noted above[125], the onus is on Canada to establish that the Canada Account financing to Air Wisconsin falls within the scope of the safe haven provided for in the second paragraph of item (k).

7.159 The second paragraph of item (k) provides

> … 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.

7.160 Neither party disputes that the Embraer offer to Air Wisconsin is not consistent with the *OECD Arrangement* [].[126] To the extent that the Canada Account financing to Air Wisconsin matches the Embraer offer, the Canada Account financing therefore matches a derogation.

7.161 In order to avail itself of the item (k) safe haven, Canada must first establish that the matching of a derogation could, as a matter of law, be "in conformity with" the "interest rates provisions" of the *OECD Arrangement*. Only if Canada establishes that this is possible as a matter of law, will we need to consider whether Canada has met its burden of establishing that the Canada Account financing to Air Wisconsin is matching according to the provisions of the *OECD Arrangement*. Similarly, only if Canada establishes that matching a derogation could, as a matter of law, fall within the item (k) safe

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[124] *First*, Brazil states that Canada failed to comply with Article 53(a) of the *OECD Arrangement*, whereby Participants "shall make every effort to verify" that terms not conforming with the *OECD Arrangement* are "officially supported". *Second*, Brazil asserts that Canada has not demonstrated that it informed its fellow Participants of the nature and outcome of the verification efforts called for by Article 53(a). Nor has it provided evidence demonstrating that it notified other *OECD Arrangement* Participants of the terms and conditions of its support for the Air Wisconsin transaction, as it is required to do under Articles 53(b) and 47(a) of the *OECD Arrangement*. *Third*, Brazil submits that Article 53, which regulates matching of non-conforming terms and conditions offered by a non-participant, does not permit non-identical matching.

[125] *See* para. 7.139, *supra*.

[126] *See* Articles [] of the *Sector Understanding on Export Credits for Civil Aircraft*.

haven, will we need to address Brazil's arguments regarding Canada's alleged failure to comply with the procedural requirements of Articles 47(a) and 53 of the *OECD Arrangement*.

7.162 In determining whether the matching of a derogation could, as a matter of law, be "in conformity with" the "interest rates provisions" of the *OECD Arrangement*, we recall that Article 31.1 of the *Vienna Convention on the Law of Treaties* provides that a treaty shall be interpreted "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

7.163 The concept of "conformity" with the "interest rates provisions" of the *OECD Arrangement* was addressed by the panel in *Canada – Aircraft – 21.5*.[127] That panel considered, on the basis of a textual analysis, 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".[128] The panel considered that its textual analysis was confirmed by the context of the second paragraph of item (k), and the object and purpose of the SCM Agreement.

7.164 With regard to matching, the *Canada – Aircraft – 21.5* panel took the view that offers that matched a permitted exception (an action itself foreseen and permitted within limits by the *Arrangement*) "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.[129] In contrast, offers that matched a derogation (an action itself not permitted under any circumstances by the *Arrangement*) 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.[130] The *Canada – Aircraft – 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.[131] The *Canada – Aircraft – 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.[132] The *Canada – Aircraft – Article 21.5* panel also stressed the importance of avoiding an interpretation of item (k), second paragraph, that would lead to structural inequity in respect of developing country Members.[133]

7.165 The findings of the *Canada – Aircraft – Article 21.5* panel on item (k) were not appealed by Canada (or Brazil) and were subsequently adopted by the DSB on 4 August 2000. The findings of that panel regarding the exclusion of the matching of a derogation from the item (k) safe haven were found "persuasive" by the *Brazil – Aircraft – Second Article 21.5* panel.[134] The report of that panel was not appealed by Canada (or Brazil) and was subsequently adopted by the DSB on

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[127] *Canada – Aircraft – Article 21.5*, Report of the Panel, footnote 57, *supra*.

[128] *Canada – Aircraft – Article 21.5*, Report of the Panel, footnote 57, *supra*, para. 5.114.

[129] *Id*., paras. 5.124 and 5.126. The *Canada – Aircraft – Article 21.5* panel referred to Articles 29 and 51 of the *OECD Arrangement* as well as Articles 25, 29(d), and 31 of the *Sector Understanding on Civil Aircraft* (*Id.*, para. 5.124 and footnote 113).

[130] *Id*., paras. 5.125-5.126. The *Canada – Aircraft – Article 21.5* panel referred to Articles 29 and 47(b) of the *OECD Arrangement* as well as Articles 25, 29(d), and 31 of the *Sector Understanding on Civil Aircraft* (*Id*., para. 5.125 and footnote 113).

[131] *Id*., paras. 5.120 and 5.125.

[132] *Id*., para. 5.134.

[133] *Id*., para. 5.136.

[134] *Brazil – Aircraft – Second Article 21.5*, Report of the Panel, footnote 35, *supra*, para. 5.113.

23 August 2001. We consider that the findings of both the abovementioned panels are persuasive, and endorse those panels' interpretations of the second paragraph of item (k). The approach of these panels appears to us to be entirely consistent with the wording of the second paragraph of item (k). Indeed, if one were to accept that the matching of a derogation could fall within the item (k) safe haven, one would effectively be accepting that a Member could be "in conformity with" the "interest rates provisions" of the *OECD Arrangement* even though that Member failed to respect the CIRR (or a permitted exception). In our view, such an interpretation would be unjustified.

7.166 Canada has sought to distinguish the findings of the *Canada – Aircraft – 21.5* panel.[135] Canada notes that the panel opined as to which provisions of the *OECD Arrangement* would constitute "interest rates provisions" on the theory that its mandate was to determine what was necessary to "ensure" compliance, and that the panel offered its opinion in the absence of an actual disputed transaction. While Canada's observations may be factually accurate, in our view they do not render the panel's reasoning any less persuasive.

7.167 Canada considers that the matching provisions of the *OECD Arrangement*, i.e., Article 29 of the main text and Articles 25 and 31 of Annex III, are in "conformity" with the "interest rates provisions", and indeed are themselves "interest rates provisions", because a body of disciplines on matching has been developed in the *OECD Arrangement* in order to "govern" this practice. In this regard, Canada refers to the procedures set forth in Articles 50 through 53. We note, however, that Canada argues that the availability of the item (k) safe haven is not conditional on fulfilment of the procedural requirements set forth in Articles 50 – 53 of the *OECD Arrangement*.[136] In our view, it would be anomalous to find that all forms of matching could in principle fall within the scope of the item (k) safe haven on the basis of the procedures set forth in Articles 50 – 53 of the *OECD Arrangement*, if compliance with those procedures was not required in order to benefit from the item (k) safe haven in a given case.

7.168 Canada also states that the Appellate Body in *Brazil – Aircraft* "mentioned the possibility of using the 'matching' provisions of the OECD Arrangement".[137] We note, however, that the Appellate Body expressly stated that "'matching' in the sense of the *OECD Arrangement* [was] not applicable in [that] case".[138] The Appellate Body cannot, therefore, be understood to have made any findings on this issue. In addition, we note that there is nothing to suggest that the Appellate Body was referring to the matching of a derogation, as opposed to the matching of a permitted exception. As explained by the *Canada – Aircraft – 21.5* panel, this distinction has significant implications for the application of the item (k) safe haven.[139]

7.169 Canada submits that the text of the *OECD Arrangement* does not support the interpretation of the *Canada – Aircraft – 21.5* panel. In particular, Canada argues that Article 29 specifically permits matching as a response to an "initiating offer" that may or may not comply with the *OECD Arrangement*. According to Canada, it is the initiating offer that may be the derogation, but never the (matching) response, because the initiating offer – when it amounts to a derogation – is

[135] Although the report of the *Brazil – Aircraft – Second 21.5* panel was not adopted at the time that the parties made their submissions in these proceedings, that panel issued its interim report to the parties on 20 June 2001, before our first substantive meeting with the parties. Thus, although we did not have access to that interim report, the parties could have taken the interim findings of that panel into account for the purpose of making their submissions in the present proceedings.

[136] Canada submits that the term "interest rates provisions" excludes "procedural requirements with which a non-Participant inherently could not comply", although Canada asserts that matching must nevertheless be "undertaken in good faith and on the basis of reasonable due diligence" (*See* First Written Submission of Canada, para. 56 and footnote 46 (Annex B-4)).

[137] First Written Submission of Canada, footnote 40 (Annex B-4).

[138] *Brazil – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 185.

[139] *See* 7.164, *supra*.

specifically prohibited under Article 27, whereas the (matching) response is specifically permitted by Article 29. We note that Canada made this argument in the *Canada – Aircraft – 21.5* proceedings, and that the panel dealt with Canada's argument by observing that, "although matching of derogations is in certain cases not prohibited, this does not alter the fact that both the original derogation and the matching remain, by the *Arrangement's* own terms *out of conformity* with the provisions of the *Arrangement*."[140] The panel also noted that "Canada's approach would directly undercut real disciplines on official support for export credits".[141] We see no reason not to adopt the same approach to Canada's argument in these proceedings. In our view, in such cases the matching interest rate is simply not "in conformity with [the interest rates] provisions", as that expression is used in the SCM Agreement.

7.170 Canada also submits that although the SCM Agreement disciplines trade distorting subsidies, the prospective nature of the dispute settlement remedies means that – in the absence of matching – illegal subsidisers will have a perpetual advantage. According to Canada, incorporating the matching disciplines of the *OECD Arrangement* in the item (k) safe haven prevents this. In our view, however, it is not entirely clear that the WTO dispute settlement system only provides for prospective remedies in cases involving prohibited export subsidies. In this regard, we recall that the *Australia – Leather – Article 21.5* panel found that remedies in cases involving prohibited export subsidies may encompass (retrospective) repayment in certain instances.[142] In any event, even if the WTO dispute settlement mechanism does only provide for prospective remedies, we note that it does so in respect of all cases, and not only those involving prohibited export subsidies. Article 23.1 of the DSU provides that Members shall resolve all disputes through the multilateral dispute system,[143] to the exclusion of unilateral self-help. Thus, to the extent that the WTO dispute settlement system only provides for prospective remedies, that is clearly the result of a policy choice by the WTO Membership. Given this policy choice, and given the fact that Article 23.1 of the DSU applies to all disputes, including those involving (alleged) prohibited export subsidies, we see no reason why the (allegedly) prospective nature of WTO dispute settlement remedies should impact on our interpretation of the second paragraph of item (k).

7.171 In addition, Canada considers it significant that the Illustrative List of Export Subsidies contained in Annex 1 of the SCM Agreement was carried over from the Tokyo Round Subsidies Code. Canada notes that the *OECD Arrangement* was adopted in 1978, after more than ten years of negotiations. In 1979, the Tokyo Round Subsidies Code was agreed together with other Tokyo Round Agreements. Given that the signatories of the GATT Subsidies Code were at the same time participants in the *OECD Arrangement*, Canada believes it is illogical that the signatories of the GATT Subsidies Code would have allowed matching in the *OECD Arrangement* but then would have forbidden it in the Subsidies Agreement one year later. In our view, it is not our role to pass judgment on the logic of the signatories of the GATT Subsidies Code. Like the *Canada – Aircraft – 21.5* and *Brazil – Aircraft – Second 21.5* panels, we have confined our interpretation to the wording of the second paragraph of item (k), read in context, and in light of the object and purpose of the SCM Agreement. Furthermore, we note that Canada refers to the GATT Subsidies Code in a section of its first written submission concerning the object and purpose of the SCM Agreement. In this regard, we do not consider that the object and purpose of the SCM Agreement is necessarily the same

[140] *Canada – Aircraft – Article 21.5*, Report of the Panel, footnote 57, *supra*, para. 5.125 (emphasis in original).

[141] *Id.*

[142] *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse by the United States to Article 21.5 of the DSU*, Report of the Panel, WT/DS126/RW, adopted 11 February 2000, para. 6.39.

[143] Article 23.1 of the DSU states: "When Members seek the redress of a violation of obligations or other nullification or impairment of benefits under the covered agreements or an impediment to the attainment of any objective of the covered agreements, they shall have recourse to, and abide by, the rules and procedures of this Understanding."

as the object and purpose of the GATT Subsidies Code. For example, the SCM Agreement provides for more extensive special and differential treatment for developing countries than the GATT Subsidies Code did. In addition, the preamble to the Marrakesh Agreement Establishing the World Trade Organization, of which Agreement the SCM Agreement is an integral part, recognises "that there is need for positive efforts designed to ensure that developing countries, and especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development". No such "need" was identified in the GATT Subsidies Code. In addition, all WTO Members are bound by the SCM Agreement, whereas only a number of GATT Contracting Parties were signatories of the GATT Subsidies Code. Furthermore, the provisions of the SCM Agreement – unlike those of the GATT Subsidies Code – are subject to binding dispute settlement under the DSU.

7.172 Canada also notes the statement by the *Canada – Aircraft – 21.5* panel that, with the scope of the item (k) exemption left in the hands of a certain subgroup of WTO Members – the Participants – to define, the second paragraph of item (k) should not be interpreted in a manner that allows that subgroup of Members to create for itself de facto more favourable treatment than under the SCM Agreement than is available to all other WTO Members.[144] Canada asserts that the application of all the "interest rates provisions" of the *OECD Arrangement* – including matching – is not de facto more favourable treatment for Participants, because the right to offer terms on a matching basis is available to all WTO Members. While we accept that all WTO Members would have the right to match derogations, were such matching to fall within the scope of the item (k) safe haven, we note that non-Participants would still be at a "systematic disadvantage as they would not have access to the information about the terms and conditions being offered or matched by Participants".[145] Thus, while both Participants and non-Participants may have the right to match derogations, it cannot be assumed that non-Participants would always have the information needed to exercise that right in practice.[146]

7.173 Canada denies that there is any "systematic disadvantage" to non-Participants, as they are under no obligation to provide information on matching offers to anyone. By contrast, Canada notes that Participants must notify their matching, which therefore is subject to prior scrutiny by other Participants. Canada further notes that, although non-Participants would not receive the terms and conditions of Participants' matching offers, Participants would likewise not receive non-Participants' matching offers. Moreover, Canada suggests that non-Participants are advantaged because the *OECD Arrangement* is a public document, and non-Participants therefore know the basic terms and conditions that Participants may offer. However, the terms and conditions of non-Participants' offers are not public knowledge.

7.174 We fail to see how the fact that matching by Participants is subject to prior scrutiny removes the "systematic disadvantage" resulting from the fact that non-Participants will have no formal means of knowing what terms and conditions (offered by Participants) they are entitled to match. Nor is this "systematic disadvantage" for non-Participants removed by the fact that Participants will not receive the terms and conditions of non-Participants' offers. The fact that Participants may not know precisely what terms and conditions are being offered by non-Participants does not change the fact that non-Participants have no formal means of knowing what terms and conditions are being offered by Participants. In addition, we consider that Canada's argument that non-Participants know what

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[144] *Canada – Aircraft – Article 21.5*, Report of the Panel, footnote 57, *supra*, para. 5.132.

[145] *Canada – Aircraft – Article 21.5*, Report of the Panel, footnote 57, *supra*, para. 5.134, and *Brazil – Aircraft – Second Article 21.5*, Report of the Panel, footnote 35, *supra*, para. 5.117.

[146] The European Communities argues that if a non-Participant has doubts about the reliability of the alleged offer of non-*OECD Arrangement* terms that it is invited to match, it may request confirmation of them from the offeror. While non-Participants may be able to obtain information in this manner, they 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*.

basic terms and conditions Participants may offer (because the *OECD Arrangement* is a public document) is irrelevant to the issue at hand. We are concerned with the matching of a derogation, which by definition is not in conformity with the terms and conditions of the *OECD Arrangement*. The point is that, while non-Participants may know what terms and conditions Participants are supposed to offer, they have no formal means of knowing when Participants derogate from those terms and conditions.

7.175 The European Communities asserts that the *Canada – Aircraft – 21.5* panel adopted a "strained reasoning" that ignores the informal and "gentleman's agreement" character of the *OECD Arrangement*, 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. According to the European Communities, a more teleological reason for the panel's conclusion was its view that matching would "directly undercut real disciplines on official support for export credits."[147] The European Communities asserts, however, that that view is not shared by the Participants to the *OECD Arrangement* themselves, who obviously regard matching as being compatible with effective disciplines on export credits.[148]

7.176 In our view, the fact that the *OECD Arrangement* allows matching of derogations, or the fact that Participants view matching of derogations as a means of disciplining export credits, does not necessarily mean that the SCM Agreement should allow matching of derogations. Unlike the *OECD Arrangement*, the SCM Agreement is not an "informal" "gentleman's agreement". The SCM Agreement therefore does not need to allow recourse to the matching of derogations in order to instil discipline. The SCM Agreement is a binding instrument, and is therefore enforceable through the WTO dispute settlement mechanism.[149]

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[147] *Canada – Aircraft – 21.5*, Report of the Panel, footnote 57, *supra*, para. 5.125.

[148] A similar argument was expressed by the United States, which referred to the matching provisions of the *OECD Arrangement* as its "key enforcement provision" (Third-Party Submission of the United States, para. 12 (Annex C-2)).

[149] In this regard, we endorse the following findings of the *Brazil – Aircraft – Second 21.5* panel: "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.

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

7.177 The United States contends that the *Canada – Aircraft – 21.5* panel's concern (in para. 5.138) that Canada's interpretation would permit Members to "opt out" of their WTO obligations on the basis of the behaviour of non-Members is misplaced, because if matching is shielded by the item (k) safe harbour, then a Member who matches a non-conforming offer is acting in accordance with its WTO obligations. In our opinion, the concern expressed by the *Canada – Aircraft – 21.5* panel was that a "Member's conformity with GATT/WTO rules [should not be] defined by the behaviour of non-Members". We agree. This concern would arise even if the inclusion of the matching of a derogation in the item (k) safe haven would mean that matching Members were acting in accordance with their WTO obligations. This is because the inclusion of the matching of a derogation in the item (k) safe haven would not establish any objective benchmark against which to determine whether or not a Member is in accordance with its WTO obligations. In any given case, the benchmark would be set by reference to the terms and conditions of the non-conforming offer. To the extent that the non-conforming offer were made by a non-WTO Member, the benchmark for determining whether or not a matching Member acts in accordance with its WTO obligations would therefore be the non-conforming terms and conditions offered by the non-Member. Thus, the fact that the matching of a derogation is included in the second paragraph of item (k) would not remove the potential for a "Member's conformity with GATT/WTO rules [to be] defined by the behaviour of non-Members".

7.178 The United States also asserts that, contrary to the *Canada – Aircraft – 21.5* panel's concern, Canada's approach to this issue does not raise the issue of "structural inequity" in respect of developing countries.[150] The United States notes that Article 27 of the SCM Agreement exempts developing countries from the prohibitions of paragraph 1(a) of Article 3, subject to compliance with the provisions in Article 27.4. This exemption applies to <u>all</u> export subsidies, not just to export credits. The United States notes that the exemption in the second paragraph of item (k), by contrast, is much more limited. Despite its more limited scope, however, the United States argues that the item (k) safe harbour was an important part of the overall package that WTO Members agreed to when they accepted the SCM Agreement.

7.179 We understand the United States to argue that the inclusion of the matching of derogations in the item (k) safe harbour would only undermine part of the special and differential treatment provided for developing country members, and that this more limited structural inequity in respect of developing countries should be tolerated because of the importance attached by Members to the item (k) safe harbour. In our view, however, Article 27 accords developing country Members special and differential treatment in respect of <u>all</u> export subsidies, whatever form they take. Thus, to the extent that an export credit constitutes an export subsidy, it falls within the scope of Article 27, and developing country Members are in principle entitled to special and differential treatment in respect of that export credit. We are therefore unable to interpret the second paragraph of item (k) in a manner that would render Article 27, in part at least, ineffective.[151]

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therefore unavailing" (*Brazil – Aircraft – Second 21.5*, Report of the Panel, footnote 35, *supra*, paras 5.114-5.115, footnotes omitted).

[150] We recall that the *Canada – Aircraft – 21.5* panel had referred to the possibility of Canada's interpretation of the second paragraph of item (k) "result[ing] in either more favourable treatment, *de facto*, for developed compared to developing countries, or the *de facto* elimination of special and differential treatment for developing countries" (*Canada – Aircraft – 21.5*, Report of the Panel, footnote 57, *supra*, para. 5.136). That panel referred to the possibility of a developed country Member matching the subsidised 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.

[151] *See United States – Standards for Reformulated and Conventional Gasoline*, Report of the Appellate Body, WT/DS2/AB/R-WT/DS4/AB/R, adopted 20 May 1996, p. 23, and *Japan – Alcoholic Beverages II*, Report of the Appellate Body, footnote 59, *supra*, p. 12.

(c) Conclusion

7.180 For the above reasons, we conclude that Canada has failed to establish that the matching of a derogation could, as a matter of law, be "in conformity with" the "interest rates provisions" of the *OECD Arrangement.* As a matter of law, therefore, the matching of a derogation could not fall within the scope of the item (k) safe haven.

7.181 In light of our conclusion in the preceding paragraph, it is not necessary for us to consider whether, as a matter of fact, the Canada Account financing to Air Wisconsin constitutes matching according to the provisions of the *OECD Arrangement*. Similarly, it is not necessary for us to examine Brazil's claims that Canada failed to comply with the procedural requirements set forth in Articles 47(a) and 53 of the *OECD Arrangement*.

3. Conclusion

7.182 We have found that the Canada Account financing to Air Wisconsin is a subsidy that is "contingent … upon export performance". We have further found that the Canada Account financing, which Canada characterises as the matching of a derogation under the *OECD Arrangement*, cannot as a matter of law benefit from the item (k) safe haven. In light of these findings, we conclude that the Canada Account financing to Air Wisconsin is a prohibited export subsidy, contrary to Article 3.1(a) of the SCM Agreement.

G. OTHER EDC TRANSACTIONS

7.183 Brazil has made detailed claims regarding financing provided by the EDC to the following purchasers of Bombardier regional jets: Atlantic Southeast Airlines ("ASA"), Atlantic Coast Airlines ("ACA"), Comair, Kendell, and Air Nostrum. The EDC provided financing to all of these airlines under the EDC Corporate Account. Some of the EDC financing to Air Nostrum was also provided under the EDC's Canada Account.

7.184 Brazil claims that the abovementioned financing took the form of prohibited export subsidies. Brazil claims that EDC financing is a direct transfer of funds in the form of a loan, which constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Brazil also asserts that the provision of loans by the EDC is a "service[] other than general infrastructure", within the meaning of Article 1.1(a)(1)(iii). Brazil claims that EDC financing confers a "benefit" within the meaning of Article 1.1(b), and is therefore a subsidy, because it is provided to the recipient airlines on terms more favourable than the recipients could obtain in the market. Brazil claims that EDC financing is "contingent … upon export performance" because the EDC was "established … for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[152]

7.185 Canada agrees that EDC financing is a "financial contribution" within the meaning of Article 1.1(a)(1)(i). However, Canada denies that the provision of EDC loans is a "service[] other than general infrastructure", within the meaning of Article 1.1(a)(1)(iii). Canada agrees that the existence of a "benefit" can be determined by examining whether or not a financial contribution is on terms more favourable than those available to the recipient in the market. According to Canada, all Corporate Account financing for regional aircraft since 1998 has been provided on a commercial basis, and therefore does not confer a "benefit". Canada does not deny that EDC support is "contingent … upon export performance".

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[152] *Export Development Act*, footnote 42, *supra*, Section 10(1); Export Development Corporation Annual Report 2000, p. 47 (Exhibit BRA-22).

7.186 In order for Brazil's claims to succeed, it must be demonstrated that the EDC loans at issue are subsidies, by virtue of being "financial contributions" that confer a "benefit". It must also be demonstrated that the EDC financing at issue, if found to constitute subsidisation, is "contingent … upon export performance".

7.187 We note that the parties agree that the EDC loans at issue take the form of "direct transfer[s] of funds" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. We agree, and therefore find that the EDC loans at issue constitute "financial contributions" within the meaning of Article 1.1(a)(1) of the SCM Agreement.[153]

7.188 Brazil makes a number of general arguments in support of its claim that the EDC financing at issue confers a "benefit". These general arguments apply in respect of most of the EDC transactions at issue. Brazil also makes a number of arguments that are transaction-specific, in the sense that they only relate to certain EDC transactions. We begin by examining whether any of the general arguments relied on by Brazil demonstrate that a "benefit" is conferred by the EDC financing at issue. We shall then examine Brazil's transaction-specific arguments. If, on the basis of the above, we find that any of the EDC financing at issue confers a "benefit", we shall then determine whether or not that EDC financing is "contingent … upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

7.189 In addressing Brazil's arguments, we will be guided by the findings of the panel and Appellate Body in *Canada – Aircraft*. In that case, the panel found that

> a financial contribution will only confer a "benefit", *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.[154]

7.190 The Appellate Body upheld the findings of the panel, ruling that

> 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.[155]

1. Brazil's general "benefit" arguments

7.191 Brazil advances four general arguments in support of its claim that the EDC financing at issue confers a "benefit". First, Brazil asserts that the EDC financing is inconsistent with certain indications of market financing allegedly relied on by Canada in the *Brazil – Aircraft – Second 21.5* proceedings. Second, Brazil asserts that the EDC's financing was offered on the basis of an unreliable credit rating tool. Third, Brazil submits that the EDC financing at issue is more favourable than a "market" benchmark constructed by Brazil on the basis of Enhanced Equipment Trust Certificate ("EETC") data. Fourth, Brazil asserts that the EDC failed to base its terms on financing procured by Bombardier customers from commercial institutions.

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[153] On the basis of this finding, we do not consider it necessary to consider whether or not the provision of EDC financing constitutes the provision of "services other than general infrastructure" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement.

[154] *Canada – Aircraft*, Report of the Panel, footnote 9, *supra*, para. 9.112.

[155] *Canada – Aircraft*, Report of the Appellate Body, footnote 9, *supra*, para. 157.

(a) Indications of market financing allegedly relied on by Canada in the *Brazil – Aircraft – 21.5* proceedings

7.192 Brazil refers to the following statements made by Canada in the *Brazil – Aircraft – 21.5* proceedings:

> British Airways, which is the best rated non-Sovereign airline, obtains rates of LIBOR [London Inter-Bank Offer Rate] + 30 to 40 bps for large aircraft deals (an additional 20-30 bps [basis points] should be added for regional aircraft, even for clients with British Airways' credit rating). This translates … to T [US Treasury fixed rate 10-year notes] + 105-120 (+125-150 for regional aircraft). … Indeed, AAA-rated industrials (and there are no airlines with this rating) cannot obtain credit at T + 20; AAA's tend to pay a spread of approximately 70 bps.[156]
>
> [A] representative sample of airline companies operating in the US market obtained financing at T+110 to 250 basis points (based on a weighted average of the different *tranches* of the financing transaction). It has also noted that the net interest rate payable by a borrower with a particularly poor credit rating may be in excess of T+350 basis points.[157]

7.193 According to Brazil, these statements mean that, "in Canada's view, the appropriate spread for the *best-rated* airline for a regional jet transaction would be either LIBOR + 50-70 bps (floating rate) or T-bill plus 125-150 bps (fixed rate transactions). For a '*representative'* airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up to T-bill + 250 bps. Airlines that are *less credit worthy* have a credit rating 'in excess of T + 350 bps'."[158] Brazil relies on this interpretation of Canada's statements to challenge EDC financing to ASA, ACA, Comair, Kendell, and Air Nostrum.[159]

7.194 Canada asserts that Brazil "misrepresents and distorts" Canada's argument in the *Brazil – Aircraft – 21.5* proceedings. According to Canada,

> [t]he essence of Canada's argument was that the rate offered under PROEX II [the Brazilian interest rate support programme at issue in *Brazil – Aircraft – 21.5*], US Treasury plus 20 bps, was not available in the market. Moreover, Canada cautioned that although that rate was under no circumstances available, the other rates to which it referred – and to which Brazil now refers in its 31 July statement – do not establish a hard limit for the international aircraft financing market. As Canada explained:
>
> > "Prevailing market conditions, different payment profiles, or terms, or other conditions negotiated between a lender and a borrower could affect the final interest rate, resulting in higher or lower rates [than those to which Canada referred in that proceeding]."
>
> Nevertheless, in paragraphs 48 and 49 of its 31 July statement and Exhibit BRA 64, Brazil attempts to attribute to Canada the position that: "For a '*representative*' airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up

[156] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU* ("*Brazil – Aircraft – 21.5*"), Report of the Panel, WT/DS46/RW, adopted 4 August 2000, Annex 1-2, footnote 26.

[157] *Id.*, Annex 1-5, para. 11. We note that a "basis point" is equivalent to 0.01 per cent.

[158] Oral Statement of Brazil at the Second Meeting of the Panel, para. 49 (Annex A-12).

[159] In particular, Brazil claims that the EDC provided financing below the spreads allegedly identified by Canada for "best-rated", "representative" and "less credit worthy" airlines.

> to T-bill +250 bps." This is patently false. Exhibit BRA-64 describes the weighted average of particular tranches of airline debt. It does not describe a generically appropriate interest-rate spread based on an airline's credit rating.
>
> Nowhere in the submissions Brazil cites, did Canada argue on the basis of that data that airlines from AAA to BBB- would have to pay spreads of up to 250 bps over US Treasury. Moreover, while Canada pointed out the rates that British Airways was paying at the time as the best-rated non-sovereign airline, Canada did not argue that highly rated airlines would have to pay US Treasury plus 125 bps or more. Canada could not have made such an argument: the data Canada provided (now Brazil's Exhibit BRA-64) shows that American Airlines, which at the time was rated BBB- by Standard & Poor's, was paying, on a weighted average basis, 111 bps over US Treasury.[160]

7.195 There is, therefore, significant disagreement between the parties as to how the abovementioned statements by Canada in *Brazil – Aircraft – 21.5* should be interpreted. In our view, Brazil seeks to make more of Canada's statements than is appropriate.[161] For example, we do not understand Canada to have advanced generally applicable interest rate spreads based on an airline's credit ratings. In any event, we do not consider it necessary to attempt to resolve the disagreement between the parties concerning Canada's statements in prior proceedings, since we have before us a far more developed factual record than was needed by or available to the panel in *Brazil – Aircraft – 21.5*. Given the volume of data before us, which includes specific spreads levied on airlines with specific credit ratings, we do not consider it necessary to concern ourselves with alleged spreads for general categories of "representative", or "best rated" airlines. To the extent that we have the means to determine what the market would charge for specific airlines with specific credit ratings, we do not consider it necessary to refer to spreads for airlines broadly categorised as "representative", or "best rated".

(b) EDC credit ratings

7.196 Brazil asserts that there are serious questions regarding the reliability of offers based on the output from LA Encore, the EDC's credit rating programme. Brazil raises two issues in this regard. *First*, Brazil asserts that LA Encore is unreliable as an objective tool. *Second*, Brazil asserts that LA Encore overstates credit ratings by four to ten notches.[162] Brazil asserts that, since each notch may account for a difference of approximately 15 basis points in the spread offered to a company,[163] this discrepancy could make a difference of between 50 and 150 basis points in an offering spread.

LA Encore unreliable as an objective tool

7.197 Brazil considers that LA Encore is unreliable as an objective tool because it has been customised to use subjective factors. Brazil asserts that Canada has not provided any information regarding the precise manner in which the EDC has customised LA Encore, or any description of the subjective factors used in the programme. Brazil asserts that Canada acknowledges that LA Encore underwent a "re-calibration of specific weighting", but does not explain how this was done. Brazil also states that the flexibility and customisation of LA Encore seems to be one of the main

[160] Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, paras. 22-24 (footnotes omitted, emphasis in original) (Annex B-12).

[161] Nevertheless, we note that Canada has not denied in these proceedings that an additional 20-30 basis points should be added to large aircraft spreads in order to arrive at an appropriate spread for regional aircraft transactions.

[162] A firm's credit rating will increase by one "notch" when the new rating is one level higher than the former rating.

[163] *See* Oral Statement of Brazil at the Second Meeting of the Panel, para. 54 (Annex A-12).

characteristics of the software. Brazil cites a finding in a report relied on by Canada to the effect that "this flexibility generally precludes the outputs of the system from being used outside the organization. The very attributes that allow extensive customization of the knowledge base for specific credit environments prevent two organizations from being able to objectively use the measure as a basis for transactions since they cannot use the (differently) customised systems as a common basis for comparison."[164]

7.198 Canada asserts that LA Encore is a computer-based company analysis software developed by a Certified Public Accounting firm and systems analyst company as a tool for analysing financial risk and comparing, on a broad basis, the financial risks associated with different companies. It is now owned by Moody's Risk Management Services, one of the two largest rating agencies in the world. (As a result, the LA Encore software has been renamed Moody's Risk Advisor, or MRA). LA Encore is used by major commercial banks such as Lloyds, Barclays, and ABN-Amro.

7.199 According to Canada, Moody's maintains each user's system to ensure consistency with the public ratings that it publishes. Moody's permits LA Encore to be tailored using customisation tools to establish or reflect an organisation's own credit practices, policy guidelines or internal ratings approach based on its own lending preferences and portfolio. The EDC has utilised the customisation features of LA Encore to reflect the EDC's own corporate risk methodologies. Canada asserts that this re-calibration of specific weightings has been undertaken to ensure that all EDC-generated ratings take into account a data-base of the current senior unsecured bond ratings of more than 900 S&P rated industrials. This allows the EDC to calibrate its own internally generated ratings with these external market benchmarks. Canada submits that the EDC's risk rating methodologies, which include the re-calibration, have been reviewed in the context of the EDC's credit risk management framework by the external risk management consultants Erisk. According to Canada, Erisk has deemed these methodologies to be in line with standard industry practice.

7.200 We do not understand Brazil to challenge the EDC's use of the LA Encore programme *per se*. Indeed, this would be difficult to accept, given the use of LA Encore by major commercial banks such as Barclays, Lloyd's, and ABN-Amro. Rather, we understand Brazil to challenge the EDC's customisation of its LA Encore programme.

7.201 As noted by Brazil, Moody's has publicised the ability to customise LA Encore (or "Moody's Risk Advisor", as it is now called). According to Moody's, LA Encore incorporates "customisation tools to establish an organisation's own credit practices, policy guidelines or internal ratings approach".[165] Such customisation may take various forms: "authoring" (to adapt the main components of the system to create a unique chart of accounts and reports); "tuner" (to reconfigure subjective questions and adjust their impacts throughout the assessment network); "screen designer" (to adjust the position of questions on the screen); "alerts" (to propagate bank policy with custom messages, help texts and alerts); "reports author" (to build custom report templates); and "administrative tools" (to configure user rights). None of these forms of customisation suggest manipulation for the purpose of providing subsidies. Indeed, we recall that the same programme, with the same scope for customisation, is also used by major commercial banks.

7.202 Canada has explained that the EDC's customisation of LA Encore has comprised the re-calibration of specific weightings, to ensure that all EDC-generated ratings take into account a database of the current senior unsecured bond ratings of more than 900 S&P rated industrials. Although Brazil has complained that Canada has not explained how this re-calibration was performed, Brazil has not argued that there is anything wrong, in principle, with customising in order to take into

[164] R. Kumra *et al.*, "Assessing a Knowledge-based Approach to Commercial Loan Underwriting", Moody's Research Report No. 2-00-1, Revised October 2000, pp. 16-17 (Exhibit CAN-73).
[165] Moody's Risk Advisor (Exhibit CAN-72).

account a data-base of the current senior unsecured bond ratings of more than 900 S&P rated industrials.

7.203 Furthermore, we note that the EDC's customised version of LA Encore is maintained by Moody's, to ensure consistency with the public ratings that it publishes. Accordingly, Moody's would ensure that the EDC's airline ratings would be consistent with Moody's own public airline ratings. We also note Canada's assertion that the EDC's credit rating methodologies, including its customisation of LA Encore, have been verified by Erisk, external risk management consultants, which has deemed these methodologies to be in line with standard industry practice. Brazil has not given us any reason to question Canada's assertion. For these reasons, we are not persuaded by Brazil's arguments regarding the EDC's customisation of LA Encore. In particular, we are not persuaded that Canada's customisation of LA Encore suggests manipulation for the purpose of providing subsidies.

7.204 On the balance of the evidence before us, we reject Brazil's arguments that LA Encore is unreliable as an objective credit rating tool.

Ratings overstated

7.205 Brazil asserts that Canada's methodology to assign credit ratings overstates ratings. Brazil states that "the ratings assigned by Canada to various borrowers were consistently higher than the ratings published for better, more credit worthy airlines".[166] According to Brazil, the "EDC's customised LA Encore system … produces ratings that are completely at odds with those published by Standard & Poor's".[167]

7.206 Brazil has made this argument most particularly in respect of EDC financing provided to Comair. In particular, Brazil notes that "Canada rated Comair at one point as [], even though Standard & Poor's does not give *any* airline this rating and, indeed, Canada itself has stated [].[168] Brazil also notes that the EDC rated Comair [] in March 1998, which – according to the Standard & Poor's data relied on by Brazil – "is a rating no other major US airline has enjoyed".[169]

7.207 Canada argues that "[r]atings are not correlated to size. For example, an airline such as Southwest, with total revenues of USD 5.6 billion is rated A by Standard & Poors and A3 by Moody's. United, a much larger airline with total revenues of USD 19.3 billion has a sub-investment grade rating of BB+/Ba1".[170] According to Canada

> [t]hough most regional airlines are not rated, it is false to assume that their ratings would necessarily be lower than the US majors. Indeed, as the following Merrill Lynch commentary notes, in many respects the regional airlines present a lower risk than their major airline counterparts:
>
> > Historically, regional airlines have been consistently more profitable than their major counterparts. As such, the stock market has "awarded" them premium valuations vis-à-vis their major partners reflecting their materially better earnings performance and prospects.

[166] Comments of Brazil on Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, para. 32 (Annex A-17).

[167] Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel, p. 7 (Annex A-16).

[168] Oral Statement of Brazil at the Second Meeting of the Panel, para. 52 (emphasis in original) (Annex A-12).

[169] *Id.*, para. 90.

[170] Comments of Canada on Responses of Brazil to Questions from the Panel Following the Second Meeting of the Panel, para. 8 (footnote omitted) (Annex B-14).

> For example, ***SkyWest with only 23 RJs, 90 turboprops and $530 million of annual revenue has an equity market value of $1.7 billion – more than Alaska and America West's combined $1.1 billion!*** And those two major airlines generate annual sales, in aggregate of $3.8 billion, with a combined fleet of 233 large, jet aircraft!
>
> We can only speculate what Comair (and ASA) would be worth at current multiples. ***However, we do know that the implied equity value for 100% of ASA and Comair was roughly $3 billion based on Delta's purchase price a few years ago – which compares to Delta's current equity value of only $5.8 billion***. [emphasis in original]

Although these comments are meant to reflect equity performance, the underlying facts are relevant to Brazil's assertions. The regional airlines have outperformed the majors in a number of key areas including revenue growth and, in terms of market capitalization, a number of the regional airlines – including Comair and ASA – are the same size if not larger than some of the US majors.

For all of these reasons, Brazil is wrong to suggest that regional airlines should pay more for financing than the major US airlines simply because of their sales revenues.[171]

7.208 In light of the evidence adduced by Canada, which is based on a report compiled by Merrill Lynch,[172] we are not convinced that Canada's credit ratings for regional airlines are unreliable simply because they are higher than Standard & Poor's public ratings for major US airlines. Canada has explained that regional airlines may be accorded higher credit ratings than major airlines because they have "outperformed the majors in a number of key areas". We note that Comair in particular has been valued very highly by Merrill Lynch. We see no reason why, had Standard & Poor's provided a public rating for Comair,[173] that public rating would not have reflected the high equity value identified by Merrill Lynch.

7.209 We note Brazil's argument that "Canada rated Comair at one point as [] and, indeed, Canada itself has stated []. Although Brazil does not specify at what point Canada rated Comair as [], we assume that it is referring to Canada's statement that the EDC offered financing to Comair in April 1996 "based on an imputed rating of [], … Today, given the availability of LA Encore, after inputting Comair's 1994, 1995 and 1996 results into LA Encore we find that the 1996 rating is calculated as []."[174] [] In our view, however, these two statements by Canada are not necessarily inconsistent. Canada did not actually rate Comair as [] in April 1996. Canada simply stated on 26 July 2001, in these proceedings, that it would have rated Comair as [] in April 1996, had it used the LA Encore programme at that time. Further, the fact that Standard & Poor's has not rated major US carriers [] does not necessarily mean that a regional carrier should not be assigned that rating. We therefore draw no conclusions from the fact that [].

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[171] *Id.*, paras. 10-12 (footnote omitted).

[172] Merrill Lynch, "Regional Airline Update: In Times of Economic Uncertainty, Look to Regional Airlines", 30 May 2001 (Exhibit CAN-103).

[173] We note that airlines will only request ratings (from companies such as Moody's and Standard & Poor's) when they intend to seek public financing. The fact that regional airlines such as Comair do not have ratings does not reflect on their creditworthiness. It simply means that they have not needed a rating for the purpose of seeking public financing.

[174] Response of Canada to Question 37 from the Panel, Responses of Canada to Questions from the Panel Prior to the Second Meeting of the Panel (Annex B-9).

7.210 Brazil also asserts that there are large changes in ratings assigned to specific regional airlines. Brazil argues that the EDC rated Comair [] in April 1996, but subsequently used its LA Encore programme to generate a rating of [], []. Similarly, the EDC rated ASA as [] in March 1997, but subsequently used its LA Encore programme to generate a rating of [], []. Canada claims that, prior to the introduction of LA Encore, the EDC did not attempt to assign precise credit ratings for potential customers.[175] It simply determined []. []. Brazil did not respond to this Canadian argument when commenting on Canada's 13 August 2001 submission. In addition, there is evidence that the EDC rated ASA [].[176] In light of Canada's assertion regarding the absence of precise credit ratings prior to the introduction of LA Encore, the corroboration of Canada's assertion in respect of ASA, and Brazil's failure to respond to Canada's assertion in its 20 August 2001 submission[177], we attach no importance to the alleged differences between the EDC's pre- and post-LA Encore ratings for Comair and ASA.

7.211 In light of the above, Brazil has not persuaded us that the EDC's credit ratings are overstated.

Conclusion

7.212 To conclude, we find that Brazil has failed to establish that there are serious questions regarding the reliability of offers based on LA Encore output.

(c) Brazil's constructed "market" benchmark

7.213 Brazil asserts that the EDC financing at issue confers a "benefit" because it is more favourable than a "market" benchmark constructed by Brazil using a base EETC[178] spread. Brazil has constructed a "market" benchmark for the majority of the EDC transactions at issue. In establishing its base EETC spread, Brazil first calculated the weighted average of bid spreads at which all airline EETCs were trading in the month of the EDC transaction at issue. Second, as a "cross-check" Brazil calculated the weighted average of offer spreads for all new airline EETCs offered in the year of the EDC transaction at issue.[179]

7.214 Canada has criticised the methodology employed by Brazil in respect of EETCs. Without addressing all of the issues raised by Canada,[180] we note that Canada has criticised Brazil's use of data for all EETCs, and Brazil's use of weighted average spreads for all tranches of an EETC.

(i) Use of data for all EETCs

7.215 Canada asserts that, although Brazil purported to only include airline EETCs in its base EETC spread,[181] it actually included EETC data in respect of non-airlines (i.e., Fed Ex and Atlas Air). According to Canada, only airline EETCs should have been considered. Brazil failed to respond to Canada's objection in its 20 August 2001 submission.

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[175] *See* Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12).

[176] *See* 1997 Shadow Bond Rating for ASA (Exhibit CAN-44).

[177] *See* Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel (Annex A-16).

[178] Enhanced Equipment Trust Certificates, or EETCs, are a secured form of financing that comprise a number of tranches. Each tranche will be assigned a credit rating, depending on the seniority of the claim of the tranche over the aircraft.

[179] *See* Comments of Brazil on Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, paras. 21 and 22 (Annex A-17).

[180] Canada's arguments are set out in full in Annex B-12.

[181] *See* Oral Statement of Brazil at the Second Meeting of the Panel, para. 65 (Annex A-12).

7.216 Given that Brazil itself purported to use only airline EETCs, and in light of Brazil's failure to respond to Canada's objection, we agree with Canada that any EETC data used for the purpose of examining the EDC's financing should not include non-airline EETCs.

(ii) Use of weighted averages

7.217 Canada criticises Brazil for using the weighted average spreads for all tranches of an EETC issuance. According to Canada, nowhere has Brazil indicated that it has considered the varying underlying credit ratings of the individual airlines or EETC loan tranches. Neglecting to consider the creditworthiness of different borrowers is a fundamental flaw. Nor does it appear to Canada that Brazil has considered the varying age or type of the underlying assets (for example, whether they are jets at all), or the market's appetite for these assets. According to Canada, Brazil's analysis also fails to address terms to maturity, loan-to-value ratios, liquidity features and cross-collateralisation of the various issues.

7.218 Brazil asserts that Canada stated in *Brazil – Aircraft – Second 21.5* that, for a given EETC, the highest-rated tranche within that EETC was a "conservative relative benchmark" for the purpose of determining "material advantage" within the meaning of the first paragraph of item (k). According to Brazil, "[g]iven that Canada has previously stated that the highest-rated tranche (with the lowest spread) was 'conservative', there is no reason to believe that Brazil's use of weighted-average spreads led in any way to an unfair comparison."[182]

7.219 We recall that EETCs are a secured form of financing that comprise a number of tranches. Each tranche will be assigned a credit rating, depending on the seniority of the claim of the tranche over the aircraft. In our view, the fact that Canada stated that the highest-rated tranche was a "conservative relative benchmark" does not mean that Canada would also consider the inclusion of weighted average spreads for all tranches as an equally "conservative relative benchmark". Indeed, this would only make sense if the use of weighted average spreads for all tranches would necessarily result in a spread that is more "conservative", and therefore lower, than the use of only the highest-rated tranches. However, this will clearly not be the case, since the inclusion of weighted average spreads for all tranches will necessarily include spreads for tranches rated lower than the highest-rated tranche. Thus, the use of weighted average spreads for all tranches of an EETC issuance would result in a benchmark spread that is higher than would be the case if only the spreads for the highest-rated tranches were included. Brazil is therefore wrong to argue that "[g]iven that Canada has previously stated that the highest-rated tranche (with the lowest spread) was 'conservative', there is no reason to believe that Brazil's use of weighted-average spreads led in any way to an unfair comparison."[183]

7.220 Furthermore, it is apparent to us that the use of weighted average spreads for all tranches of an EETC issuance could result in a benchmark spread that is higher than would be the case if only the spreads for the appropriately-rated tranches were included. This could lead to a finding of below-market financing (by reference to Brazil's EETC benchmark), when in fact the transaction at issue may have been at, or above, market. For these reasons, we have considerable reservations regarding Brazil's use of weighted average EETC data, especially given the availability of airline-specific data in the record.

(iii) Conclusion

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[182] *See* Comments of Brazil on Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, para. 15 (Annex A-17).

[183] In addition, we note that Canada's remarks in *Brazil – Aircraft – 21.5* were made in respect of establishing a market benchmark for the purpose of determining the existence of "material advantage" (item (k), second paragraph). There is no reason for us to assume that Canada would necessarily take the same approach when establishing a market benchmark for the purpose of determining the existence of "benefit".

7.221 In light of the above, we are not persuaded that it is appropriate to rely on Brazil's constructed "market" benchmark for the purpose of determining whether or not the EDC financing at issue confers a "benefit".

(d) Bombardier customers' commercial financing

7.222 Brazil notes that, in its response to Panel Question 43, Canada stated that over [] per cent of Bombardier's sales did not involve any government support, even through so-called "market window" operations.[184] According to Brazil, these transactions would provide a plentiful and accurate resource for determining the appropriate market rates for Canada's officially-supported transactions. Brazil asserts that it is difficult to see how Canada could reasonably arrive at market rates for its transactions without ever referring to the vast majority of Bombardier transactions that it claims were financed without any government participation, even market window participation.

7.223 Canada asserts that where such information is available, the EDC does consider it to the extent that it is relevant. Canada also argues that, to the extent that such information is available, it confirms that the EDC's pricing was at or even above commercial market financing. However, Canada submits that it is often difficult to obtain complete information on the financing provided by banks and other financial institutions due to their confidentiality policies.

7.224 We consider that it would be unrealistic to expect the EDC to have access to data regarding all commercial financing transactions involving Bombardier regional jets. The EDC is not a party to such transactions, and has no right to obtain details of those transactions. Indeed, it is likely that the terms of those transactions are viewed as confidential by the parties.

7.225 In any event, evidence in the record suggests that the EDC has referred to commercial financing for Bombardier regional jets where possible. For example, a December 1996 EDC memo refers to financing from European banks for regional jets purchased by [].[185] In addition, EDC documentation refers to offers of financing by European banks to [].[186]

7.226 Thus, we do not consider that EDC financing should be deemed to confer a "benefit" simply because the EDC failed to base its financing in all cases on the terms of commercial financing provided to Bombardier customers.

(e) Conclusion

7.227 In light of the above, we are not persuaded by the general arguments raised by Brazil in support of its claim that the EDC financing at issue confers a "benefit". We shall now examine the transaction-specific "benefit" arguments put forward by Brazil.

2. Brazil's transaction-specific "benefit" arguments

7.228 As noted above, Brazil has made claims concerning specific EDC Corporate Account financing to ASA, ACA, Comair, Kendell, and Air Nostrum. Brazil has also made claims against EDC Canada Account financing to Air Nostrum. We shall now examine each of these transactions in turn, noting that the EDC offered more than one loan to some of these airlines.

[184] The term "market window" is used by the parties to describe the provision of financing by EDC on terms that are, according to Canada, consistent with those that are available in the market.
[185] *See* Exhibit CAN-59, p. 6.
[186] *See* Exhibit CAN-39.

Note for public version of report: The Panel accepted Canada's position that the interest rates and fees offered or charged by the EDC and *IQ* should be treated as confidential business information. The Panel noted that detailed knowledge about the considerations and benchmarks it used to determine whether the EDC interest rates at issue conferred a benefit under the SCM Agreement would enable those interest rates to be derived, to varying degrees of precision, for the transactions analysed by the Panel. Accordingly, the Panel concluded that it was necessary to redact significant parts of its report. Nonetheless, the Panel agreed with Brazil that it was important that the considerations and benchmarks used by the Panel be identified. Those considerations and benchmarks included:

(i) Commercial Interest Reference Rates (CIRRs) (as set by the OECD)

(ii) the EDC's minimum lending yield (an internal rate set by the EDC)

(iii) an EETC issued by a major U.S. airline

(iv) two bond issues of a major U.S. airline

(v) information on rates reportedly offered by other major banks

The considerations and benchmarks referred to in items (iii) and (iv) were proposed by Canada and were used after consideration of the relevance of their terms and conditions compared to those of the EDC transactions examined. Not all five considerations and benchmarks were used in examining each EDC transaction.

1.229 In examining Brazil's claims in this case, we shall consider whether or not a "benefit" is conferred on Bombardier by virtue of a "benefit" being conferred on the airline customer purchasing Bombardier aircraft.[187] In this regard, Brazil argues that there can be a "benefit" to Bombardier even if there is no "benefit" to the purchasing airline, e.g., even if the EDC provides financing to the purchasing airline on terms that are not more favourable than those that the airline could obtain in the market. In short, Brazil argues that if "Embraer … offers to arrange financing at γ per cent, while Bombardier is able to provide government financing at γper cent[,] [t]he government support has benefited Bombardier by relieving it of the necessity of providing or arranging its own financing, even though the customer may view the offers as equal, and therefore not be benefited."[188] In our view, the fact that Bombardier may arrange financing in the form of government support does not necessarily confer a "benefit" simply because Bombardier is "reliev[ed] … of the necessity of providing or arranging its own financing". If that were the case, a "benefit" would be conferred whenever Bombardier arranged external financing – even through commercial banks – since any external financing would "reliev[e] it of the necessity of providing or arranging its own financing". We find it difficult to accept that the existence of "benefit" (in the context of financing) is determined

[187] We endorse the following statement by the *Brazil – Aircraft – Second 21.5* panel: "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" (*Brazil – Aircraft – Second 21.5*, Report of the Panel, footnote 35, *supra*, para. 5.28, footnote 42) (emphasis in original).

[188] *See* Response of Brazil to Question 59 from the Panel, Responses of Brazil to Questions from the Panel Following the Second Meeting of the Panel (Annex A-14).

on the basis of whether or not Bombardier provides internal or external financing. The existence of "benefit" (in the context of financing) is determined by reference to the terms at which similar financing is available to the airline customer in the market. The abovementioned market comparison indicates that a number of the specific transactions at issue in these proceedings do not confer a "benefit" on the airline customer, and therefore neither on Bombardier. In respect of these specific transactions, Brazil has failed to provide any evidence of "benefit" accruing to Bombardier absent any "benefit" to the airline customer.

(a) ASA – March 1997

7.230 The EDC offered financing to ASA in March 1997. In March 1997, the EDC rated ASA as []. The EDC offered financing at US Ten-Year Treasury Notes (hereinafter "T") plus [] basis points, for [].

7.231 Brazil claims that the terms of the EDC's March 1997 offer to ASA conferred a "benefit" because the repayment term exceeded the maximum authorised under the *OECD Arrangement*, and the spread offered by the EDC was [].[189]

(i) Repayment term

7.232 Brazil notes that Article 21 of the *Sector Understanding on Export Credits for Civil Aircraft* provides for a maximum repayment term for regional aircraft of 10 years. According to Brazil, a repayment term in excess of 10 years is positive evidence of "material advantage" (within the meaning of item (k), first paragraph) and, a fortiori, a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

7.233 Canada claims that the *OECD Arrangement* is not necessarily reflective of market terms. Canada also asserts that repayment terms for regional aircraft financing routinely exceed 10 years.

7.234 In addressing Brazil's argument, we are aware that the Appellate Body found in *Brazil – Aircraft* 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'".[190] However, the fact that the *OECD Arrangement* can be used as a market benchmark for the purpose of determining the existence of "material advantage" does not necessarily mean that it should also serve as a benchmark for the purpose of determining the existence of "benefit". If one were to draw this conclusion, one would be equating "benefit" with "material advantage", and the Appellate Body has made it clear that this is not possible as a matter of law. In *Brazil – Aircraft*, the Appellate Body stated that "if the 'material advantage' clause in item (k) is to have *any* meaning, it must mean something different from 'benefit' in Article 1.1(b)".[191]

7.235 We note that a "benefit" is only conferred when financing is made available to the recipient on terms more favourable than the recipient could obtain in the market. Thus, Brazil might have been able to demonstrate that a repayment term in excess of ten years confers a "benefit" by establishing that such repayment terms are not available in the market. However, Brazil failed to do this. By contrast, Canada has adduced evidence of instances in which the repayment term of market financing

[189] CIRRs are Commercial Interest Reference Rates within the meaning of Article 15 of the *OECD Arrangement*.

[190] *Brazil – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 181.

[191] *Id.*, para. 179 (emphasis in original). The *Brazil – Aircraft – Second 21.5* panel understands the Appellate Body to mean that it is "impermissible" to interpret the term "benefit" to have the same meaning as the term "material advantage" (*See Brazil – Aircraft – Second 21.5*, Report of the Panel, footnote 35, *supra*, footnote 50).

for regional aircraft transactions exceeds 10 years. In particular, Canada has referred the Panel to the 1997 issuance by Northwest Airlines of pass-through certificates financing 12 British Aerospace Avro RJ85 aircraft. The term for the 1997-1A (Class A) certificates is 18.25 years.[192] Canada has also referred the Panel to the 1997 issuance by Continental Airlines of pass-through certificates financing nine Embraer EMB-145ER Regional Jets. The term for the 1997 3A (Class A) certificates is 15.25 years.[193] In addition, Canada has submitted the Morgan Stanley Dean Witter Report, which offers additional evidence that the standard length of financing available in the market for regional aircraft financing ranges from 10 to 18 years.[194] This report contains information on structured transaction pricing in the commercial marketplace. It indicates that US airlines have financed regional aircraft in the market using enhanced equipment trust certificate (EETC) tranches that feature a greater than 10 year term of maturity. For example, the EETC Class A and B tranches issued on 19 September 1997 by Atlantic Coast Airlines for 6 CRJ-200 and 8 British Aerospace J-41 aircraft have terms of maturity of respectively 16 years (Class A) and 13 years (Class B). In our view, this evidence – which has not been disputed by Brazil – demonstrates that repayment terms of up to 18.25 years are available in the market. Thus, the fact that a given repayment term may exceed the 10-year term provided for in Article 21 of the *Sector Understanding on Export Credits for Civil Aircraft* does not mean *ipso facto* that financing is provided on terms more favourable than those available to the recipient on the market.

7.236 For these reasons, we reject Brazil's argument that a repayment term of more than 10 years is in itself positive evidence of a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

(ii) []

7.237 Brazil asserts that the interest rate offered to ASA in March 1997 is []. Brazil argues that an interest rate [] is positive evidence of "material advantage" (item (k), first paragraph) and, a fortiori, a "benefit".

7.238 Canada denies that interest rates [] necessarily confer a "benefit", as the CIRR lags behind the market.

7.239 We have already noted the Appellate Body's finding in *Brazil – Aircraft* 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'".[195] We also noted the Appellate Body's statement that "material advantage" should not be equated with "benefit". Furthermore, in *Brazil – Aircraft – 21.5* the Appellate Body stated that "[t]he 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".[196]

7.240 Canada has explained that the CIRR lags behind the market, so that at a given point in time financing [] is not necessarily more favourable than that available to the recipient on the market. In this regard, Canada refers the Panel to the following argument it made before the *Brazil – Aircraft – 21.5* panel:

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[192] *Northwest Airlines 1997-1 Pass Through Trusts*, Credit Suisse First Boston, Lehman Brothers, Morgan Stanley Dean Witter, Prospectus, 16 September 1997 (Exhibit CAN-54).

[193] *Continental Airlines 1997-3 Pass Through Trusts*, Morgan Stanley Dean Witter, Prospectus, 23 July 1997 (Exhibit CAN-55).

[194] "EETC Market Update: Monthly Update: Airlines" (Morgan Stanley Dean Witter, Fixed Income Research, North America, Investment Grade Credit – Industrials), 10 February 2001 (Exhibit CAN-14).

[195] *Brazil – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 181.

[196] *Brazil – Aircraft – 21.5*, Report of the Appellate Body, WT/DS46/AB/RW, adopted 4 August 2000, para. 64.

> A meaningful comparison of market transactions to CIRR is difficult due to the fact that the CIRR is a constructed rate, while commercial aircraft transactions are priced at commercial rates available at the time of the specific transaction. To recall, the CIRR is determined by taking the average of the 7-year Treasury rate (in the case of deals with repayment terms up to 10 years) for the previous month and adding 100 bps. For example, the CIRR for the period 15 September – 15 October would be constructed using the average of the 7-year Treasury for the month of August, plus 100 bps. Carrying on with the example, the result of this calculation is that the CIRR applicable to transactions closing during the period from 15 September through 15 October would [be] a rate that was calculated using the average of the applicable Treasury rate during August, i.e. up to two months earlier. To an entity that operates on the basis of commercial principles, the calculation of the CIRR is such that it would not be considered a reliable reflection of current market conditions.[197]

7.241 Brazil has not disputed that the CIRR lags behind the market.[198] Nor has Brazil disputed that the CIRR may not be a reliable reflection of current market conditions. However, we also note that "CIRRs should represent final commercial lending interest rates in the domestic market of the currency concerned", and "should closely correspond to the rate for first-class domestic borrowers".[199] For this reason, we consider that the CIRR could, in the absence of additional evidence regarding market rates, serve as "a *rough* proxy for commercial interest rates".[200] In our view, therefore, the fact that an interest rate is [] constitutes evidence that the interest rate would be more favourable than rates available in the market, and in the absence of any counter-evidence on market rates, would justify a finding that such an interest rate confers a "benefit".

(iii) Market benchmarks proposed by Canada

7.242 Canada has provided evidence that the EDC March 1997 offer to ASA (T plus []) was higher, and therefore less favourable, than the market spreads for a specific tranche of a [], for certain [], and for the general industrial index for similar credit ratings. Canada therefore denies that the EDC March 1997 offer to ASA confers a "benefit".[201]

[]

7.243 Canada compares the EDC's March 1997 offer to ASA with a [].

7.244 Brazil has not expressly challenged Canada's reference to the spreads for specific EETC tranches in these proceedings. On several occasions, Brazil refers to Canada's own references to

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[197] *Brazil – Aircraft – 21.5*, Report of the Panel, footnote 156, *supra*, Annex 1-4, Responses of Canada to Questions from the Panel Posed on 3 February 2000, Response to Question 4(a) from the Panel, p. 82.

[198] The "lag" will be more pronounced if market interest rates move quickly, as appears to have happened in the period April 1996 to August 1997 (*See* Exhibit CAN-59).

[199] *OECD Arrangement*, Article 15.

[200] *Brazil – Aircraft – Second 21.5*, Report of the Panel, footnote 35, *supra*, para. 5.35 (emphasis in original).

[201] Brazil notes that Canada has not provided pricing memos for the ASA and ACA transactions. According to Brazil, therefore, the Panel has no way of knowing whether the benchmarks referred to by Canada in Annex II to its 13 August 2001 submission were the actual benchmarks used by EDC to price the transaction, or whether, instead, Canada searched for the specific purpose of this dispute for any benchmark that falls below the rates it offered ASA and ACA. In our view, it is not necessary for a Member to demonstrate that it applied specific benchmarks at the time of providing a "financial contribution" in order to rely on those benchmarks for the purpose of rebutting claims of "benefit". There is no reason why the absence of "benefit" cannot be demonstrated on the basis of an *ex post* rationalisation, provided the benchmarks relied on relate to the time that the transaction was made.

EETC spreads in order to justify Brazil's recourse to EETC data. As noted above, we do not agree with Brazil's use of weighted average EETC data. This does not mean, however, that we should also reject Canada's use of EETC data. This is because Canada does not rely on weighted average EETC data. Rather, Canada has adduced evidence regarding issues of specific EETC tranches. The criteria applied by Canada in selecting these specific EETC tranches (in particular, that the credit rating of the EETC tranche be [], and that the EETC be issued within at least 90 days prior to the Loan's Date of Offer – *See* Annex II to Canada's submission of 13 August 2001) have not been challenged by Brazil. Since Canada is not relying on average EETC data, and in the absence of any objections raised by Brazil regarding Canada's use of specific EETC tranches, we see no reason not to take into account the specific EETC tranche data submitted by Canada.[202]

7.245 We note that the EDC's March 1997 offer to ASA is [] basis points [] than the spread for the [] tranche. Since ASA and the [] tranche were rated [] secured at that time, there is no need to make any credit rating adjustment. However, we note that, according to evidence adduced by Canada, the "vast majority"[203] of EETCs are for large aircraft, and that only one EETC has been placed to finance regional jets.[204] From this evidence, we understand that the [] relates to large aircraft. In the *Brazil – Aircraft – Second 21.5* proceedings, Canada asserted that spreads for regional aircraft transactions are 20-30 basis points higher than spreads for large aircraft transactions.[205] Accordingly, the EDC's March 1997 offer to ASA should be reduced by 20-30 basis points, to enable a proper comparison with the (large aircraft) [] tranche.[206] The adjusted EDC offer would be T + [], which is significantly lower than the spread for the comparable [] tranche identified by Canada.

[]

7.246 Canada has also asserted that the EDC March 1997 offer to ASA was less favourable than [] corporate bonds issued by [], rated [] unsecured, issued in []. In March 1997, the [] were trading at T plus [] and [], i. e., at a lower spread than that offered by the EDC to ASA. These bonds met a number of qualitative criteria set by Canada (in particular, the bonds are [], so they provide a measure

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[202] In relying on company-specific EETC data, however, we note that both parties have expressed reservations regarding the reliability of EETCs as a market benchmark. For example, Canada asserts that it "never suggested that EETCs could identify the 'market' spread for a particular regional aircraft financing transaction, nor did it rely on EETCs for that purpose" (Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, para. 31 (Annex B-12)). Brazil asserts that "the credit risk or spread on a EETC issue would generally be lower than the spread that the same airline could obtain in a commercial bank-financed transaction" (Oral Statement of Brazil at the Second Meeting of the Panel, para. 64 (Annex A-12)). We take note of these comments when comparing EDC financing with company-specific EETC data.

[203] Communication of 7 August 2001 from CIT Structured Finance (Exhibit CAN-79).

[204] Communication of 8 August 2001 from Babcock & Brown (Exhibit CAN-79).

[205] See para. 7.192, *supra*.

[206] In its request for interim review (*See* para. 6.11, *supra*), Canada objected to the Panel's addition of 20-30 basis points to large aircraft EETC spreads to arrive at an appropriate regional aircraft spread. The Panel made this adjustment in response to Brazil's reliance on statements made by Canada in the *Brazil – Aircraft – Second 21.5* proceedings (*See* paras. 47 and 50 of Oral Statement of Brazil at the Second Meeting of the Panel (Annex A-12)). In responding to Brazil's oral statement (*See* Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12)), Canada made no attempt to deny the need for a 20-30 basis point adjustment when converting from large aircraft to regional aircraft spreads. Nor did Canada object to Brazil's inclusion of a 20 basis point adjustment ("for the difference between the regional aircraft used in the financing at issue and the larger jets used in the typical EETC issue") in its Exhibit BRA-66. Furthermore, although Canada asserted at interim review that "[v]ariations in pricing between similar but non-identical asset classes are dynamic and subject to change …", Canada did not deny the need for an adjustment *per se*. However, although Canada appeared to accept the need for an adjustment of some sort, Canada failed to indicate what would be, in its view, an appropriate adjustment for the transactions at issue. In addition, we note that a lesser adjustment would not necessarily change the outcome of our findings.

of the spread attributed to an airline credit rating, rather than the security provided by an aircraft type, and they have an [] on the date the relevant EDC loan was offered).

7.247 In its 20 August 2001 submission, Brazil accuses Canada of using corporate bonds "in the large aircraft sector without any consideration of whether these spreads should be adjusted for the regional aircraft sector even though … Canada has said that spreads for the regional aircraft sector should be 20-30 points higher than in the large aircraft sector".[207] In this regard, we note that Canada stated in the *Brazil – Aircraft – 21.5* proceedings that "an additional 20-30 bps should be added [to large aircraft spreads] for regional aircraft".[208] However, we do not understand Canada to have argued that a regional carrier will necessarily have to pay more for credit than a major carrier. In fact, Canada has expressly argued that this will not necessarily be the case.[209] Rather, we understand Canada to have argued that a higher spread will have to be paid for financing purchases of regional aircraft as opposed to large aircraft, since large aircraft offer better security than regional aircraft. Indeed, Brazil itself has argued that this will be the case.[210] In other words, the spread adjustment depends on the type of aircraft at issue (because regional aircraft offer less security than large aircraft), and not on the nature – or size – of the carrier at issue. As noted above, the two [] relied on by Canada are unsecured, such that they reflect the credit rating of the carrier, and not the security of the aircraft type. Accordingly, Brazil's objection is not a sufficient basis for rejecting Canada's use of the two [] to justify the EDC's March 1997 offer to ASA.

7.248 Brazil has also criticised Canada for using data from one period to justify pricing in another, despite the fact that Canada already criticised Brazil for allegedly doing the same thing (in its oral statement at the second meeting). Thus, Brazil asserts that "Canada relies on the [] issued in March 1997 to support *every* comparison with the exception of the Atlantic Coast Airlines February 1996 and Kendell Airlines August 1999 offers. Canada uses these bonds as representative comparisons in charts covering financing offered in July 1996 (a year before []), March 1998, August 1998, February 1999, and March 1999".[211] We recall, however, that the relevant []. When these bonds are referred to by Canada, it cites the price at which the bonds were trading at the time of the transaction at issue. Thus, for the ASA March 1997 and August 1998 offers, Canada refers to the March 1997 and August 1998 prices for the relevant []. Similarly, for the EDC's March 1999 offer to ACA, Canada refers to the price at which the [] were trading in March 1999. We therefore reject Brazil's argument that Canada used data from one period to justify pricing in another.

General industrial index

7.249 Canada has also sought to justify the pricing of the EDC's March 1997 offer to ASA on the basis of the spreads for general industrial bonds with similar credit ratings. In particular, Canada has relied on general industrial indices derived from Bloomberg US Fair Market Yields – Industrial.

7.250 Although Brazil has made some limited use of these same general industrial indices,[212] Brazil believes that the utility of indices of general industrial bonds as a proxy for identifying market rates for financing of regional jet transactions is limited by several factors. First, the 10-year general industrial corporate bonds represent simple averages at which bonds issued by a wide variety of

[207] Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel, para. 27 (footnote omitted) (Annex A-16).

[208] *Brazil – Aircraft – 21.5*, Annex 1-2, footnote 26.

[209] See paras. 7.207-7.208, *supra*.

[210] Comments of Canada on Responses of Brazil to Questions from the Panel Following the Second Meeting of the Panel, para. 13 (Annex B-14).

[211] Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel, para. 26 (Annex A-16).

[212] *See* Oral Statement of Brazil at the Second Meeting of the Panel, para. 97 (in respect of ACA) (Annex A-12).

companies in a wide variety of industries are trading at a given point in time. While bonds issued by airlines may be included in the calculation of this average, the average itself does not reveal whether bonds issued by a particular sector should be valued above or below the average at a particular point in time. Second, there are substantial differences in liquidity between the average industrial spreads and a bank loan financing a regional jet purchase. The industrial spreads are based on thousands of bonds being traded in huge volumes (with daily trading volume estimated at $10 billion) by traders around the world each day. A bank loan to finance a particular purchase of a regional jet, on the other hand, is an isolated transaction, much less liquid, requiring much greater and more immediate assumption of risk by a lender than the lender would experience buying and selling general industrial bonds. Third, general industrial bonds do not accurately reflect the spreads for industry sectors that may not normally be publicly rated or issue corporate bonds, such as many airlines that purchase regional jets. Moreover, the different risks between airline companies and industrial companies are not necessarily reflected in the different ratings of the companies. A major airline rated A-, such as Southwest Airlines, may trade at a different spread than, for example, a major computer company with the same rating. This difference in spreads reflects differences in the market estimation of the prospects for each industry, the nature of the collateral securing each bond, competitiveness within each industry, and the manner in which the bonds are structured within each industry. These factors are reflected to some extent within the ratings, but are largely left to the discretion of the market. According to Brazil, spreads change a lot more frequently than do credit ratings. In the event of a change in the performance of a particular bond issuer or its industry, the market will react much more immediately than will the credit ratings agencies. Brazil submits that the result will be a discrepancy between the spreads at which similarly rated companies in different industries may trade.

7.251 According to Brazil, the market agrees that the general industrials curves do not reflect the peculiarities of the regional airlines industry. For example, in a report on EETCs, Salomon Smith Barney ("SSB") states that "EETCs trade at a considerable premium compared with comparably rated generic corporate bonds."[213] SSB's analysis supports Brazil's and the market's views that companies with the same credit rating will not necessarily enjoy the same spreads when issuing papers in the bonds market. Moreover, the similarity in ratings does not in itself mean that companies will obtain financing at the same spreads for particular transactions. For example, Southwest Airlines is a major airline with revenues of $5.6 billion in 2000 and a fleet of over 350 Boeing large jets and no regional jets.[214] This is a substantially different company from Atlantic Southeast Airlines (ASA), which had revenues of $410 million in 1998.[215] Southwest is currently rated A- by Standard & Poor's.[216] Assuming that ASA, with less than one-tenth of Southwest's sales revenues,[217] was also rated A- by the EDC, this does not mean that the market would finance a sale of 20 regional jets to ASA at the same rates as it would finance a sale of the same size to Southwest.

7.252 Canada notes Brazil's argument that the different risks between airline companies and industrial companies are not necessarily reflected in the different ratings of the companies. However, Canada suggests that such individualised risks are taken into account by the EDC in its transaction-specific assessment of risk. Canada also asserts that much of Brazil's criticism of the use of general industrial indices turns on its assertion that smaller companies will not have access to financing at the same rates as larger companies, even when they have the same credit rating. Canada asserts that

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[213] *The ABCs of EETCs – A Guide to Enhanced Equipment Trust Certificates*, Salomon Smith Barney, 8 June 2001, p. 37 (Exhibit BRA-71).

[214] http://www.southwest.com/about_swa/press/factsheet.html.

[215] http://www.rati.com/airlines/AirlineFinance. 1998 is the most recent year for which information regarding ASA is publicly available.

[216] Exhibit BRA-67.

[217] According to Brazil, many other factors in addition to sales revenues would enter into this calculus. Brazil uses sales revenue merely to illustrate that while companies' credit ratings may be equivalent, the terms at which the companies might obtain financing may not necessarily be so.

regional airlines have outperformed the majors in a number of key areas including revenue growth and, in terms of market capitalisation, a number of the regional airlines – including Comair and ASA – are the same size if not larger than some of the US majors. Canada therefore submits that Brazil is wrong to suggest that regional airlines should pay more for financing than the major US airlines simply because of their sales revenues.[218]

7.253 Although Canada has addressed some of the concerns raised by Brazil, it has not responded to all of them. In particular, Canada has not responded to Brazil's observation that the 10-year general industrial corporate bonds represent simple averages at which bonds issued by a wide variety of companies in a wide variety of companies in a wide variety of industries are trading at a given point in time. In the absence of compelling assurances by Canada that the difficulties identified by Brazil regarding the use of average data are misplaced, we do not consider it appropriate (especially given the availability of company-specific bond data submitted by Canada) to base our findings (for any of the EDC transactions at issue) on a comparison of the EDC's financing terms with average spreads offered in the general industrial corporate bond market.

Conclusion

7.254 We recall that the EDC's March 1997 offer to ASA was priced [], and that a [] interest rate constitutes evidence that the interest rate would be more favourable than rates available in the market, and in the absence of any counter-evidence, would justify a finding that such an interest rate confers a benefit.[219] Here, there is additional relevant evidence on market rates. While the EDC's March 1997 offer to ASA is priced [] the [] tranche of the [], it is priced [] the March 1997 spread for [].[220] On balance we find that there is credible but conflicting evidence on whether the EDC's March 1997 offer was below market. Thus, on the basis of the evidence presented, we conclude that Brazil has failed to establish that the EDC's March 1997 offer to ASA was priced below market and conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

(b) ASA – August 1998

7.255 The EDC offered financing to ASA in August 1998 at T plus [], for []. At that time, ASA was rated [] secured / [] unsecured by the EDC.

7.256 Brazil claims that the EDC's August 1998 offer to ASA confers a "benefit" because the repayment term exceeded the maximum authorised under the *OECD Arrangement*, and the spread offered by the EDC was [].

7.257 We recall our finding that a repayment term in excess of the 10-year period authorised by the *OECD Arrangement* is not positive evidence of "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. We also recall, however, that the fact that an interest rate is [] constitutes evidence that the interest rate would be more favourable than rates available in the market, and in the absence of any counter-evidence on market rates, would justify a finding that such an interest rate confers a "benefit".[221]

7.258 Canada has relied on a number of factors to demonstrate that the EDC's August 1998 offer to ASA was consistent with the market. Without referring to each and every factor identified by Canada, we first note that Canada has relied on the [] tranche of a [] issued in [] at T plus []. Although

[218] For a full description of Canada's arguments on this issue, *see* para. 7.207, *supra*.
[219] *See* para. 7.241 *supra*.
[220] As to the weight to be given to individual company EETC data, we recall that both parties have expressed some reservations. *See* footnote 202, *supra*.
[221] *See* para. 7.241 *supra*.

there is no need for any credit rating adjustment, we recall that EETC's have generally been issued in respect of large aircraft, and that the EDC's offer should therefore be adjusted, i.e., reduced, by 20-30 basis points to a "large aircraft level". The adjusted EDC offer would be T + [], which is [] than the price of the [] tranche of the [] identified by Canada.

7.259 Second, we note that Canada relies on the price at which [] were trading in August 1998. Although these bonds were priced at T plus [] and [] respectively, i.e., in excess of the EDC offer, these [] were rated [] at that time, [] than ASA's unsecured rating of []. As noted above, Brazil has asserted that each notch may account for a difference of up to 15 basis points.[222] On this basis, the price of the [], adjusted [] to [] (i.e., reduced by [] basis points to T plus [] and []), would be [] than the EDC's August 1998 offer to ASA (i. e., T plus []).[223] Canada has submitted evidence to the effect that adjusting a credit rating from [] to [] would result in a [] basis point reduction in interest rates.[224] Such adjustment would reduce the price of the [] to T plus [] and [], again [] the EDC's August 1998 offer to ASA.

7.260 We recall that the EDC's August 1998 offer to ASA was priced [], and that a [] interest rate constitutes evidence that the interest rate would be more favourable than rates available in the market, and in the absence of any counter-evidence, would justify a finding that such an interest rate confers a benefit.[225] Here, there is additional relevant evidence on market rates. While the EDC's August 1998 offer to ASA is priced [] the [] tranche of the [], it is priced [] the August 1998 spread for [].[226] On balance we find that there is credible but conflicting evidence on whether the EDC's August 1998 offer was below market. Thus, on the basis of the evidence presented, we conclude that Brazil has failed to establish that the EDC's August 1998 offer to ASA was priced below market and conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

(c) ACA – February 1996

7.261 The EDC issued an indicative term sheet (providing for financing at T plus []) to ACA in February 1996, when the EDC rated ACA [] secured / [] unsecured. No formal offer was made by the EDC at that time.

7.262 According to Brazil, "Canada defends its pricing of offers to [ACA] in part on the ground that one of its offers was ultimately not accepted by ACA. Brazil notes that whether or not EDC's early offers were accepted, EDC appears to have relied on its February 1996 offer to ACA in pricing EDC support for the Comair transaction. … Thus, these offers provide further evidence that EDC does not follow market principles".[227]

7.263 In our view, there is no basis for us to make any findings regarding the February 1996 indicative term sheet. This term sheet was not binding on the EDC, and the terms therein would not necessarily have been reflected in any financing ultimately offered[228] by the EDC to ACA. For these

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[222] *See* para. 7.196, *supra*.

[223] As noted above (*See* para. 7.247, *supra*), there is no need to adjust the EDC offer to take into account the type of aircraft at issue when comparing EDC's offer with [], since these are [] corporate bonds.

[224] *See* Appendix 1 to Annex II of Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12).

[225] *See* para. 7.241 *supra*.

[226] As to the weight to be given to individual company EETC data, we recall that both parties have expressed some reservations. *See* footnote 202, *supra*.

[227] Comments of Brazil on Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, para. 47 (Annex A-17).

[228] Although Brazil refers to a February 1996 "offer", only an indicative term sheet was issued by the EDC at that time.

reasons, we find that the indicative term sheet is not a "financial contribution" within the meaning of Article 1.1(a) of the SCM Agreement.

7.264 The fact that the EDC may have referred to its February 1996 indicative term sheet for ACA in respect of pricing offered to Comair is without consequence. The fact that the indicative term sheet may have been referred to in respect of Comair may be relevant when reviewing the EDC's financing to Comair. However, that does not mean that it is of such a nature as to constitute a "financial contribution" to ACA.

(d) ACA – March 1999

7.265 In March 1999, the EDC offered ACA fixed rate financing at T plus [], or floating rate financing at LIBOR plus [], over []. At the time, the EDC rated ACA [] secured / [] unsecured.

7.266 Brazil submits that the EDC's offer was below market, because it was priced []. In its 13 August 2001 submission, Canada argues that the price at which [] was trading in March 1999 "does not provide a good 'on the run' benchmark" because it was "not frequently traded". Canada notes that this was the reason cited by SSB for excluding [] from its EETC database.[229] In our view, the fact that an EETC is not frequently traded could be a valid reason for disregarding it for the purpose of establishing valid market benchmarks against which to compare the EDC's financing. In addition, we note that Brazil did not object to Canada's statement that the [] "does not provide a good 'on the run' benchmark". Accordingly, we draw no conclusions regarding the consistency with the market of the EDC's March 1999 offer to ACA on the basis of the price at which [] was trading at that time.

7.267 Brazil also asserts that the EDC's March 1999 offer to ACA was compared to the sale of a [] to [].[230] In this regard, we note that Exhibit CAN-39, which contains the pricing strategy for an offer to Kendell, refers to the price of prior EDC loans to [] and ACA. The EDC therefore clearly took the price of an earlier loan to [] into account when pricing its loan to Kendell. However, this does not mean that the EDC also took its loan to [] into account for the purpose of its financing to ACA. We therefore do not see the relevance of Brazil's argument to our examination of the EDC's financing to ACA.[231]

7.268 In order to demonstrate that the EDC's March 1999 offer to ACA is consistent with the market, Canada asserts, *inter alia*, that earlier financing offered by the EDC had only been used for the acquisition of [] by November 1999. Canada asserts that financing for other CRJs acquired by ACA came from a combination of []. Canada submits that the EDC was advised that the financing from [] in 1998 was priced at T plus [] over [].[232] The EDC was also advised that financing from [] was offered in early 1999 at Libor plus [] basis points, corresponding to approximately T plus [], based on November 1999 swap rates.[233] We note that the EDC's March 1999 offer was less favourable than these offers from [] and [], which are commercial operators.

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[229] Exhibit CAN-81.

[230] *See* Oral Statement of Brazil at the Second Meeting of the Panel, para. 104, referring to Exhibit CAN-39 (Annex A-12).

[231] We note that Canada has responded to Brazil's argument in the context of the EDC's financing to Kendell, and not in the context of the EDC's financing to ACA (*See* Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, para. 18 (Annex B-12)).

[232] In its oral statement at the second meeting of the Panel, Brazil indicated [].

Brazil first made a claim regarding the EDC's March 1999 offer to ACA at the second meeting of the Panel. Documentary evidence regarding the EDC's March 1999 offer to ACA was therefore not covered by earlier requests by the Panel for documents / supporting evidence regarding EDC financing. However, there is no basis for us to doubt the veracity of Canada's assertions regarding financing offered by [].

[233] Reference to the [] financing is contained in EDC documents submitted as Exhibit CAN-39.

7.269 Canada has also submitted evidence indicating that [] (then rated []) were trading at T plus [] and [] in March 1999. Since these [] are rated the same as the EDC's unsecured rating for ACA, there is no need for any credit rating adjustment when comparing the price of the EDC's offer with the price of the []. The EDC's March 1999 offer (i. e., T plus []) is [] than the price at which [] were trading in March 1999.

7.270 Although the EDC's offer was [] than the relevant [] pricing, other factors enumerated above indicate that the EDC's March 1999 offer to ACA was not made on terms more favourable than those available to ACA on the market. For this reason, we find that the EDC's March 1999 offer to ACA did not confer a "benefit".

(e) Comair – July 1996

7.271 The EDC offered Comair financing for [] aircraft in July 1996 at T plus [] basis points, for a period of []. The EDC rated Comair [] (secured) / [] (unsecured) at that time.

7.272 Brazil claims that the EDC's offer confers a "benefit", because it is []. Brazil also asserts that the offer was not consistent with commercial principles because the EDC took into account [].[234]

Minimum Lending Yield ("MLY")

7.273 Canada has submitted evidence indicating that the EDC's July 1996 offer was [] bps [] the EDC's MLY. According to the EDC Resolution Respecting MLYs, "[]".[235] This would imply that EDC financing [].[236] Canada has consistently argued in these proceedings that the EDC operates on commercial principles.[237] Thus, we are entitled to presume that the EDC's definition of [] would be the same as that of a commercial lender. Accordingly, the fact that the EDC finances [], and therefore does not include [], would suggest that the EDC is financing below market, and therefore confers a "benefit". However, this conclusion should not be drawn if there is other specific evidence indicating that the financing at issue was not made available on terms more favourable than those available to the recipient on the market.

[]

7.274 Evidence submitted by Canada also demonstrates that, for the purpose of formulating its July 1996 offer to Comair, the EDC took into account [].[238] In certain circumstances, the fact that the EDC provides financing on the basis of [] may suggest that the financing is not consistent with commercial principles, and therefore below market, since commercial lenders would be unlikely to take into account []. However, this conclusion would not be reached if there is other specific evidence that the financing is not more favourable than financing available to the recipient on the market.

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[234] *See* Exhibit CAN-59, p. 3.

[235] *See* Exhibit CAN-47.

[236] Canada has asserted that "the fixed margin for credit risk may be [] on the authority of the President or Senior Vice President Finance and Chief Financial Officer of EDC". According to Canada, "an authorized margin [] the identified fixed margin is the [] for that transaction". We have evidence that EDC offered financing [] to Comair in two transactions: in July 1996 and August 1997. None of the documentary evidence submitted by Canada regarding these transactions contains any details regarding the basis on which the President or Senior Vice President Finance and Chief Financial Officer of EDC may have authorised the [] of the fixed margin for credit risk. Nor does it contain any data indicating that any margin authorised by the President or Senior Vice President Finance and Chief Financial Officer of the EDC was [] for the two transactions at issue (*See* paras 6.13 and 6.14, *supra*).

[237] First Written Submission of Canada, para. 19 (Annex B-4).

[238] *See* Exhibit CAN-59, p. 3.

Market indicators submitted by Canada

7.275 Canada has submitted evidence that the EDC's July 1996 offer to Comair was less favourable than the general industrial index for bonds of the same credit rating (i.e., [] secured / [] unsecured). As noted above, however, we do not consider it appropriate to base our findings on data of such a general nature.

7.276 Canada has also provided evidence that [], rated [], were trading at T plus [] and [] in July 1996. There is no need for any credit rating adjustment to this price, since the [] were rated the same as Comair's unsecured rating. The EDC's offer (of T + []) to Comair is [] than the price of the [].[239]

7.277 Canada has also asserted that, at the time of the EDC's pricing of its July 1996 offer to Comair, there were "recent market pricing indications for Comair" of T plus [] and []. In particular, an Annex attached to an internal EDC memo dated 10 April 1996 includes the following passage:

> Benchmarks:
>
> 1.[][240]

Again, the EDC's July 1996 offer to Comair is priced [] these market indicators.

7.278 Thus, the above evidence submitted by Canada to demonstrate that the EDC's offer was consistent with the market, actually indicates that the EDC's July 1996 offer to Comair was made on terms more favourable than those available to Comair in the market. Although the abovementioned Annex also states that "[t]he [] banks have indicated an agreement with [the EDC's] pricing strategy"[241], we do not consider that this general assertion without reference to specific interest rates is sufficient to rebut the specific evidence submitted by Canada. In addition, we recall that the EDC's July 1996 offer is [], and that in making its offer the EDC considered []. On balance, therefore, we find that the EDC's July 1996 offer to Comair did confer a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

(f) Comair – December 1996 and March 1997

7.279 In December 1996 and March 1997, the EDC offered financing to Comair at T plus [] basis points, for []. Since Brazil has not made any specific arguments regarding these transactions, there is no basis for us to find that they confer a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. In any event, we note that there is ample evidence to suggest that the EDC's December 1996 offer to Comair was priced above offers from commercial banks.[242]

(g) Comair – August 1997

7.280 In August 1997, the EDC offered Comair financing at T plus [] basis points, for [].

7.281 Brazil asserts that the EDC's offer conferred a "benefit" because it was [], and []. We recall that the fact that an interest rate is [] constitutes evidence that the interest rate would be more favourable than rates available in the market, and in the absence of any counter-evidence on market rates, would justify a finding that such an interest rate confers a "benefit".[243] We also recall that EDC

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[239] At para. 7.209, we note that Canada calculated an *ex post* 1996 rating of [] for Comair. Adjusting the [] prices to reflect a [] rating would clearly result in EDC's offer being priced even lower than the [].

[240] *See* Exhibit CAN-59, p. 4.

[241] *See* Exhibit CAN-59, p. 5.

[242] *See* Exhibit CAN-59, p. 6.

[243] *See* para. 7.241 *supra*.

financing [] suggests the existence of a "benefit", although this conclusion should not be drawn if there is other specific evidence demonstrating that the EDC's offer is not more favourable than financing available to the recipient on the market.[244]

7.282 Thus, in order to rebut Brazil's claim of "benefit" on the basis of the two abovementioned factors, Canada should have adduced specific evidence indicating that the EDC's offer was not made on terms more favourable than those available to Comair in the market. Canada has failed to do so. Instead, Canada has submitted evidence containing a broad statement to the effect that in August 1997 "[m]arket interest in financing of the new Comair aircraft remain[ed] very strong, from []. As such, pricing [was] anticipated to be in the range of Treasuries plus [] basis points."[245] This statement is not sufficient to rebut Brazil's claim of "benefit".

7.283 In light of the fact that the EDC's August 1997 offer to Comair was [] and [], and in the absence of specific evidence demonstrating that the EDC's offer was not made on terms more favourable than those available to Comair in the market, we find that the EDC's August 1997 offer to Comair conferred a "benefit".

(h) Comair – March 1998

7.284 In March 1998, the EDC offered Comair financing at [] plus [] basis points, for []. The EDC rated Comair [] secured / [] unsecured at that time.

7.285 Brazil asserts that the EDC's offer confers a "benefit", because the EDC's offer was [].[246]

7.286 The "comparables" referred to by Brazil are those set forth in Annex II of Canada's submission dated 13 August 2001. They include the general industrial index, the [] tranche of a []. As noted above, we do not consider it appropriate to base our findings on data submitted by Canada regarding the general industrial index. Regarding the [] tranche of the [], we note that it was issued in February 1998 at T plus []. The average rating of the split[247] [] tranche is [][248], which is []. We recall that, according to Brazil, [] may require a 15 basis point adjustment. This would lead to an adjusted [] price of T plus [] basis points, which is [] the EDC's offer to Comair.[249] We further recall the need to increase EETC prices by 20-30 basis points, to arrive at an EETC price for regional aircraft transactions. The further adjusted [] price would be T plus [], which is [] than the EDC's offer to Comair.

7.287 The [] cited by Canada were rated [], some [] than the EDC's unsecured rating for Comair ([]). An adjustment must therefore be made before comparing the price of the [] with the EDC's March 1998 offer to Comair. If one assumes 15 basis points per notch, as Brazil has suggested[250], the adjusted [] prices would be reduced by [] basis points, from T plus [] and [] to T plus [] and T plus []. Canada has submitted evidence to the effect that a change in rating from [] to [] would lead to a [] basis point spread reduction. Thus, using Canada's spread adjustment, the adjusted [] prices would be

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[244] *See* para. 7.273 *supra*.

[245] See Exhibit CAN-59, p. 8.

[246] Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel, para. 42 (Annex A-16).

[247] A company has a split rating when it is rated differently by Moody's and Standard & Poor's.

[248] Canada submits that Moody's [] correlates to Standard & Poor's [] (*See* p. 12 of Annex II to Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12)). This has not been disputed by Brazil.

[249] Appendix 1 to Annex II of Canada's 13 August 2001 submission does not indicate what adjustment Canada considers would be appropriate to reflect a rating change of [] to [] (*See* Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12)).

[250] *See* para. 7.196, *supra*.

T plus [] and []. Using either Brazil's or Canada's adjustment, therefore, the adjusted [] prices would be lower, and more favourable, than the EDC's March 1998 offer to Comair.

7.288 Canada has also presented data regarding an [], rated [], and priced at T plus []. Canada notes that [] is not a commercial airline, and "therefore has less relevance in this analysis". Since [] is not a commercial airline, we do not consider that the price of its EETCs has any relevance for the purpose of reviewing the EDC's offers to commercial airlines.[251]

7.289 Canada has also asserted that the EDC's March 1998 offer to Comair was deemed appropriate by the EDC "in comparison with ASA".[252] In this regard, we note that an internal EDC memo dated 10 March 1998 refers to a financing agreement "recently entered into" by the EDC with ASA. However, the record indicates that the only EDC financing to ASA in existence in March 1998 dates back to March 1997. We do not consider that the EDC's March 1997 financing to ASA is sufficiently contemporaneous for the purpose of reviewing the EDC's March 1998 offer to Comair.

7.290 We recall that the EDC's offer was priced [] favourably than the adjusted [] price, but [] favourably than the adjusted [] prices. We further recall the reservations expressed by both parties regarding the use of company-specific EETC data.[253] On balance we find that there is credible but conflicting evidence on whether the EDC's March 1998 offer was below market. Thus, on the basis of the evidence presented, we conclude that Brazil has failed to establish that the EDC's March 1998 offer to Comair was priced below market and conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement.

(i) Comair – February 1999

7.291 The EDC offered Comair [] financing at T plus [][254] in February 1999, when the EDC rated Comair [] secured / [] unsecured.

7.292 Regarding the EDC's February 1999 offer to Comair, Brazil argued that the offer was below market because it was made at [] basis points above the EDC's cost of funds. It appears to us that this argument is based on the incorrect assumption that the offer was at T plus [] basis points, while we find the evidence demonstrates that the offer was made at T plus [] basis points and we will examine the transaction on that basis.[255]

7.293 Canada asserts that the EDC's pricing strategy considered a basket of US industrials including banks, industrials and consumer goods companies with a like credit rating and actively trading bonds with a similar term to maturity as the average life of the financing offered to Comair. According to Canada, the average spread on such bonds was T plus [] basis points, [] basis points lower than the

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[251] See para. 7.216, *supra*.

[252] Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel, para. 76 (Annex B-12).

[253] See footnote 202, *supra*.

[254] Brazil has queried whether EDC's offer was T plus [] or T plus [], as the EDC recommendation contained in Exhibit CAN-59 refers to T plus []. Since the formal 26 February 1999 offer contained in Exhibit CAN-58 refers to T plus [], we see no reason to doubt Canada's assertion that the EDC's February offer was T plus []. Having assumed that the EDC's offer was actually T plus [], Brazil argued that the EDC's offer was below market because it was [] basis points above its cost of funds. Brazil did not state that this argument would apply equally in the event that the EDC actually offered T plus [] – or cost of funds plus 14 basis points (which Brazil merely compared with the general EETC market (*See* Oral Statement of Brazil at the Second Meeting of the Panel, para. 94 (Annex A-12)). Since we do not accept Brazil's suggestion that the EDC actually offered T plus [], we do not consider it necessary to address Brazil's argument that the EDC's offer was below market because it was [] basis points above its cost of funds.

[255] *See* Oral Statement of Brazil at the Second Meeting of the Panel, para. 94 (Annex A-12).

EDC's February 1999 offer to Comair. Canada submits that the EDC [], the average spread of which (T plus [] basis points) was also lower than the EDC's February 1999 offer to Comair.

7.294 As noted above, we do not consider it appropriate to base our findings on average industrial bond spreads, especially when airline-specific benchmarks are available. Since Canada has adduced evidence regarding the [] tranche of a [], we shall base our findings on those indicators. The [] tranche of the [] was issued in [] at T plus []. This price would increase to T plus [] when one adds the 20 - 30 basis point regional aircraft premium. The EDC's offer is [] than the adjusted [] price.

7.295 [] were trading at T plus [] and [] in February 1999, when they were rated []. Since Comair was rated by the EDC as [] unsecured at that time, the price of the [] should be adjusted to reflect the [] difference in credit ratings. According to Brazil, a [] adjustment would cause the [] prices to decrease by [] basis points, to T plus [] and [], which is [] than the EDC's February 1999 T plus [] offer to Comair. According to evidence submitted by Canada, interest rates would decrease by [] basis points if a credit rating improved from [] to [].[256] This would lead to an adjusted price of T plus [] and [] for [], which is also [] than the EDC's offer to Comair. Using both Brazil and Canada's adjustment methodologies, therefore, the adjusted [] prices are [] than the EDC's February 1999 offer to Comair.

7.296 Thus, the EDC's February 1999 offer to Comair is priced [] the [] tranche of the []. The EDC's offer is also priced [] the February 1999 spread for [].[257] On the basis of the specific market evidence presented by Canada, therefore, we conclude that the EDC's February 1999 offer to Comair was more favourable than Comair could have obtained in the market. Accordingly, we find that the EDC's February 1999 offer to Comair did confer a "benefit".

(j) Kendell – August 1999

7.297 The EDC offered financing to Kendell in August 1999 at T plus [], for []. According to Canada, the EDC participated on an equal risk-sharing basis with seven other commercial lenders: []. Canada asserts that this was a commercial transaction, as the terms and conditions were dictated by the arranging banks [], and the financing was not conditional upon the EDC's participation. Canada asserts that the EDC was a price-taker, and not a price-maker, in this transaction. Canada also asserts that the EDC participated in this deal on a *pari passu* basis.

7.298 Brazil asserts that the EDC's offer to Kendell confers a "benefit" because the [] repayment term exceeds the maximum provided for in Article 21 of the *Sector Understanding on Export Credits for Civil Aircraft*. As noted above, Brazil has not established that a repayment term in excess of 10 years is necessarily more favourable than that available on the market. Accordingly, we decline to find the existence of a "benefit" on this ground.

7.299 Brazil also asserts that the transaction is not commercial, as alleged by Canada, since the fact that the EDC provided a large part of the financing means that this was an officially supported transaction. In this regard, Brazil queries whether the EDC participated in the transaction on a *pari passu* basis. Brazil also submits that Canada's assertion that the EDC financed [] per cent of the transaction is inconsistent with a statement in Exhibit CAN-39 that "[i]t is anticipated that EDC will fund up to []% of the notes while [] together with [] other identified underwriters, will hold the other []%". Brazil also states that Canada has provided no support for its assertion that the EDC was

[256] *See* Appendix 1 to Annex II of Response of Canada to Oral Statement of Brazil at the Second Meeting of the Panel (Annex B-12).

[257] As to the weight to be given to individual company EETC data, we recall that both parties have expressed some reservations. *See* footnote 202, *supra*.

merely a price-taker in this instance. In any event, Brazil submits that the EDC's presence in the deal necessarily affected the financing terms.

7.300 Dealing first with the extent of the EDC's participation in the Kendell August 1999 transaction, Canada has stated that the "EDC was responsible for [] percent, not [] percent of the lending provided".[258] Canada has also asserted that, ultimately, [] banks also participated in the deal, alongside the EDC. It is clear, therefore, that the EDC's share of the financing was greater than that of at least some of the [] participating banks. According to Brazil, this means that the Kendell transaction was officially supported, rather than commercial. We do not agree. Provided the basic terms and conditions of the deal were fixed by commercial banks, and provided the EDC was exposed to the same risk of non-repayment of its loan as those commercial banks, we see no reason why this transaction should not be deemed to be commercial.

7.301 Brazil also asserts that the deal was not commercial because the EDC's presence necessarily affected the terms of the financing. We would only be able to accept this argument if it were clear that the banks' participation was dependent on participation by the EDC, or that the EDC was exposed to a greater risk (of default) than the participating banks. However, Canada has submitted that the deal was not dependent on the EDC's participation. According to Canada, the EDC was simply invited to participate as a price-taker. This is confirmed by evidence in the record.[259] Furthermore, the EDC was exposed to the same risk of default as the participating banks.[260] For these reasons, we reject Brazil's argument that the EDC's participation in the Kendell transaction necessarily affected the terms of the transaction.

7.302 Thus, in view of the fact that the terms and conditions of the financing provided by the EDC were arranged by commercial banks, and that the terms and conditions of the financing were not dependent on the EDC's participation, and since the EDC's exposure to the risk of repayment was the same as commercial banks, on balance we consider that this financing is on market terms, and not officially supported. We therefore find that the EDC's August 1999 financing to Kendell did not confer a "benefit".

(k) Air Nostrum

7.303 The EDC offered financing to Air Nostrum in October 1998, under both the Corporate Account and the Canada Account. The EDC's Corporate Account financing was priced at [] per cent (for []), whereas its Canada Account financing []. Financing was also provided under the *IQ* programme (at [] per cent).

7.304 Brazil asserts that the EDC's financing to Air Nostrum conferred a "benefit" because the weighted average interest rate for the deal ([] per cent) is [] for Deutschmark-denominated transactions ([]).

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[258] Oral Statement of Canada at the Second Meeting of the Panel, para. 50 (Annex B-10). The EDC's [] per cent participation is not inconsistent with the statement in Exhibit CAN-39 that "[i]t is anticipated that EDC will fund up to [] per cent" of the deal. Provided the EDC ultimately financed [] per cent or less of the deal, its participation is consistent with that statement.

[259] *See* the Executive Summary contained in Exhibit CAN-37, whereby "[t]he Joint Arrangers/Underwriters are now seeking to offer to selected financial institutions the opportunity to buy Loan Notes to be issued under the Facility". Furthermore, the EDC Pricing Strategy contained in Exhibit CAN-39 states "[g]iven this pricing has already been committed, EDC, as participant, would be expected to accept pricing or stand aside".

[260] This is evidenced by the fact that the EDC would share *pari passu* in the security (*See* Exhibit CAN-39).

7.305 According to Canada, Air Nostrum confirmed to the EDC that the Government of Brazil had offered long term financing for the Embraer contract, which was not consistent with *OECD Arrangement* terms. On the basis of this information, the EDC, with Canada Account support, provided a financing proposal which attempted to match the lease payment structure required by Air Nostrum but with a higher all-in rate than that being offered by Brazil. The EDC notified the OECD of its intention to match Brazil's offer. Canada submits that, though the overall pricing was driven by Canada's desire to match the Brazilian offer and to meet Air Nostrum's lease payment structure requirements, it was also based on a review of the airline's financial and operating performance.

7.306 In our view, it is not appropriate to analyse the EDC's financing to Air Nostrum on the basis of the weighted average of the interest rates payable to EDC Corporate Account, EDC Canada Account, and *IQ*, since Brazil has challenged each of these programmes (and specific transactions under these programmes) separately. Accordingly, the financing provided to Air Nostrum under each of these programmes should be examined separately. We examine the Canada Account and Corporate Account financing to Air Nostrum below.[261]

7.307 As noted above, the EDC Canada Account financing to Air Nostrum was []. There is no question that an [] loan confers a "benefit", since such a loan would not be available on the market.[262]

7.308 With regard to the EDC's Corporate Account financing to Air Nostrum, Brazil's claim depends on finding that the weighted average interest rate was [] per cent, and therefore [] for Deutschmark-denominated transactions. As noted above, however, the rate charged by the Corporate Account was [] per cent, and we decline to analyse the EDC financing to Air Nostrum on the basis of a weighted average interest rate.[263] Since Brazil has adduced no other transaction-specific arguments demonstrating that EDC's Corporate Account financing to Air Nostrum confers a "benefit", there is no basis for us to make such a finding.

Conclusion

7.309 For the above reasons, we find that financing provided under the EDC Corporate Account to ASA, ACA, Kendell, Air Nostrum and Comair in December 1996, March 1997, and March 1998 does not confer a "benefit", and therefore does not constitute a subsidy. It is therefore not necessary for us to consider whether or not the abovementioned EDC Corporate Account financing is "contingent … upon export performance". However, we find that EDC Corporate Account financing to Comair in July 1996, August 1997 and February 1999 does confer a "benefit", and is therefore a subsidy. In addition, we find that the EDC's Canada Account financing to Air Nostrum is a subsidy. In order to determine whether or not these subsidies are prohibited export subsidies, we must consider whether or not the financing at issue is "contingent … upon export performance".

3. Is the EDC's Corporate Account financing to Comair "contingent … upon export performance"?

7.310 Brazil asserts that the EDC, which operates the Corporate Account programme, was "established for the purposes of supporting and developing, directly or indirectly, Canada's export

[261] Regarding the alleged *IQ* financing to Air Nostrum, *see* footnote 289.

[262] Although Canada has referred to the matching provisions of the *OECD Arrangement*, Canada has made no attempt to demonstrate that the Canada Account financing to Air Nostrum falls within the safe haven provided for in the second paragraph of item (k).

[263] In any event, we recall our earlier finding that below-CIRR financing does not necessarily confer a "benefit" (*See* para. 7.241 *supra*.).

trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[264]

7.311 *First*, we note that Canada does not deny that the Corporate Account financing to Comair is "contingent … upon export performance". *Second*, we consider that the above-mentioned statutory mandate of the EDC indicates that any financing it provides under the Corporate Account programme is necessarily "contingent … upon export performance", since anything the EDC does is statutorily for the purpose of "supporting and developing … Canada's export trade". For these reasons, we find that the Corporate Account financing to Comair is "contingent … upon export performance".

4. Is the EDC's Canada Account financing to Air Nostrum "contingent … upon export performance"?

7.312 Brazil asserts that the Canada Account offer to Air Nostrum is "contingent … upon export performance" because "[t]he Canada Account is used to support export transactions", and because Canada Account is one way for the EDC to satisfy its "mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities"[265].

7.313 In addressing Brazil's claim of export contingency, we note *first* that Canada does not deny that the Canada Account financing to Air Nostrum is "contingent … upon export performance". *Second*, we note that Canada itself has stated that the mandate of the Canada Account is "to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[266] *Third*, we recall that the EDC, which operates the Canada Account programme, was "established for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[267] We therefore consider that any financing provided by the EDC under the Canada Account is necessarily "contingent … upon export performance", since anything the EDC does is statutorily for the purpose of "supporting and developing … Canada's export trade". *Fourth,* we note that the *Canada – Aircraft* panel found that the EDC Canada Account debt financing at issue in that case was "contingent … upon export performance".[268] For these reasons, we find that support provided under the Canada Account programme, including the financing to Air Nostrum, is "contingent in law … upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

5. Conclusion

7.314 To conclude, we find that financing provided under the EDC Corporate Account to ASA, ACA, Kendell, Air Nostrum and Comair in December 1996, March 1997 and March 1998 is not a subsidy.

7.315 We find, however, that the EDC's Corporate Account financing to Comair in July 1996, August 1997 and February 1999, and the EDC's Canada Account financing to Air Nostrum, take the form of subsidies that are "contingent … upon export performance". We therefore find that the EDC's Corporate Account financing to Comair in July 1996, August 1997 and February 1999, and the EDC's Canada Account financing to Air Nostrum, are prohibited export subsidies, contrary to Article 3.1(a) of the SCM Agreement.

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[264] *Export Development Act*, footnote 42, *supra*, Section 10(1).
[265] Industry Canada News Release, 10 January 2001(Exhibit BRA-3).
[266] *Id*.
[267] *Export Development Act*, footnote 42, *supra*, Section 10(1).
[268] *See Canada – Aircraft*, Report of the Panel, footnote 35, *supra*, para. 9.230.

H. *IQ* EQUITY GUARANTEES

7.316 Brazil claims that a number of equity guarantees provided by *IQ* to airlines constitute prohibited export subsidies, contrary to Article 3.1(a) of the SCM Agreement. Brazil's claim concerns *IQ* equity guarantees provided to ACA (May 1997), Air Littoral (August 1997), Midway (July 1998), Mesa Air Group ("Mesa") (September 1998 and December 1999), Air Nostrum (January 1999), and Air Wisconsin (December 2000).[269]

7.317 Brazil claims that these *IQ* equity guarantees are subsidies because they are "financial contributions" that confer a "benefit". Brazil asserts that an *IQ* equity guarantee constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) and (iii) of the SCM Agreement. Brazil submits that an *IQ* equity guarantee confers a "benefit" because equity guarantees are not available in the market,[270] and because they allow recipient airlines to pay less for equity than they would have to absent the *IQ* equity guarantee. Brazil submits that *IQ* equity guarantees are both *de jure* and de facto "contingent … upon export performance".

7.318 Canada acknowledges that *IQ* equity guarantees constitute potential direct transfers of funds, and therefore "financial contributions", within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. Canada denies that the *IQ* equity guarantees at issue confer a "benefit", however, because *IQ* charges market-based fees for those equity guarantees. Canada rejects Brazil's claim that *IQ* equity guarantees are either *de jure* or de facto "contingent … upon export performance".

7.319 In order to examine Brazil's claim against the aforementioned *IQ* equity guarantees, we must determine whether or not *IQ* equity guarantees are "financial contributions" that confer a "benefit". If so, we must determine whether such *IQ* subsidies are "contingent … upon export performance".

1. Are *IQ* equity guarantees "financial contributions"

7.320 The parties agree that *IQ* equity guarantees are "potential direct transfers of funds" within the meaning of Article 1.1(a)(1)(i). We see no reason to disagree, and therefore find that *IQ* equity guarantees are "financial contributions".[271]

2. Do the *IQ* equity guarantees confer a "benefit"?

(a) Arguments of the parties

7.321 Brazil asserts that equity guarantees, otherwise known as first loss deficiency guarantees, do not appear to be available commercially. According to Brazil, Embraer has been informed that equity guarantees are not available in the market. In support, Brazil has submitted letters from two commercial banks.[272] Brazil submits that because *IQ* is offering something that the market does not provide, the provision of an equity guarantee by *IQ* is "quintessentially" a benefit.

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[269] Brazil initially alleged *IQ* support to Atlantic Southeast and Northwest (*See* First Written Submission of Brazil, para. 91 (Annex A-3)). However, Canada has denied any *IQ* or SDI involvement in those transactions (*See* Response of Canada to Question 38 from the Panel, Responses of Canada to Questions from the Panel Prior to the Second Meeting of the Panel (Annex B-9)).

[270] *See*, for example, Response of Brazil to Question 53 from the Panel, Responses of Brazil to Questions from the Panel Prior to the Second Meeting of the Panel (Annex A-11).

[271] Since we have found that *IQ* equity guarantees are "financial contributions" on the basis of Article 1.1(a)(1)(i), there is no need for us to examine Brazil's claim that *IQ* equity guarantees constitute "financial contributions" by virtue of Article 1.1(a)(1)(iii).

[272] *See* Exhibit BRA-50.

7.322 Irrespective of the availability of equity guarantees in the market, Brazil submits that government guarantees to an equity investor protect that investor from the risks inherent in the equity market, and confer a "benefit" by making equity capital available to finance aircraft transactions on terms more favourable than would be the case in the market in the absence of the guarantee. Brazil asserts that, in order to demonstrate that there is no "benefit", Canada would have to prove that *IQ*'s fees are equal to those charged regional aircraft purchasers by commercial guarantors with A+ credit ratings. Furthermore, drawing on the logic of Article 14(c) of the SCM Agreement, Brazil asserts that there will be a "benefit" whenever a regional aircraft purchaser – which inevitably has a lower credit rating than the Government of Québec – receives an *IQ* equity guarantee, and there is a difference between the amount it pays for equity and the amount it would pay for equity absent the *IQ* guarantee.

7.323 Canada denies that *IQ* equity guarantees confer a "benefit" by providing something not available in the market. Canada asserts that equity guarantees are offered commercially in the market. Canada refers to evidence concerning the provision of equity guarantees by engine suppliers.[273] Canada also refers to evidence regarding risk transfer instruments available in the market.

7.324 Canada asserts, on the basis of the Appellate Body report in *Canada – Aircraft*, that whether a benefit has been conferred can be determined by whether a recipient has received a financial contribution on terms more favourable than those available to it in the market. Canada notes the Appellate Body's finding that Article 14 of the SCM Agreement is relevant context in interpreting Article 1.1(b) and supports its view that the marketplace is an appropriate basis for comparison. According to Canada, however, there is no reason why Article 14(c) would be more relevant than any other part of Article 14, because Article 14(c) addresses loan guarantees, which are not at all equivalent to equity or first-loss deficiency guarantees. For Canada, the question of whether or not a "benefit" is conferred by *IQ* equity guarantees is a function of whether or not the recipient (*i.e.* the aircraft purchaser) obtains the financial contribution on terms more favourable than those available to it in the market.

7.325 Canada denies that *IQ* equity guarantees confer a "benefit", and accuses Brazil of failing to recognise that most guarantors, including *IQ*, charge fees for their guarantees.[274] In particular, *IQ* receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure.[275]

7.326 According to Canada, the market nature of the *IQ* guarantee can only be demonstrated by considering the value of the guarantee in light of the risk exposure of *IQ*. In this regard, Canada asserts that *IQ*'s risk exposure is greatly diminished [].[276] Bombardier provides to IQ a counter-guarantee pursuant to which []. [] are more than adequate to compensate it for its risk and service.

7.327 Canada submits that the market nature of the annual fee is further demonstrated by the fact that, on average, Bombardier customers using *IQ* equity guarantees have chosen to do so on less than [] per cent of their unit volume. According to Canada, this proves that in practice, *IQ* provides financing services in competition with other financial institutions interested in participating in the

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[273] *See*, for example, Exhibit CAN-13.

[274] Brazil has asserted that *IQ* Decree 1488-2000 eliminates fees as a condition for the grant of *IQ* equity guarantees. Canada denies this. The Panel does not consider it necessary to address this issue at this juncture, as we are not at present examining the *IQ* programme "as such". To the extent that Decree 1488-2000 relates to fees charged for any of the specific *IQ* transactions at issue, we shall examine that instrument when reviewing those specific transactions.

[275] Bombardier counter-guarantees [].

[276] Brazil queried whether such counter-guarantees are actually offered by Bombardier *per se*, or by Canadair Québec Capital ("CQC"), a company capitalized in equal parts by Bombardier and a company wholly-owned by *IQ*. Canada has confirmed that it is Bombardier, not CQC, that is responsible for the counter-guarantees. [].

aircraft financing market and that for the great majority of aircraft sold by Bombardier, the *IQ* guarantee is not sufficiently attractive to Bombardier's customers. In other words, the fact that [] per cent of the aircraft being financed are financed without *IQ* equity guarantees demonstrates that most of the time, Bombardier's customers are, at best, indifferent to *IQ* equity guarantees. For Canada, the necessary implication of these circumstances is that the fees charged by *IQ* in return for the guarantees are market rate; otherwise Bombardier's customers would not be so indifferent as to their availability.

7.328 Brazil asserts that whether or not Bombardier or some other entity provides [] counter-guarantees to *IQ* is irrelevant. By providing guarantees to the borrower, *IQ* facilitates more favourable financing terms because of Québec's superior credit rating, thus conferring a benefit. This is what "sweetens" the deal for the purchaser of Bombardier aircraft, and therefore, for Bombardier itself.

7.329 Brazil notes Canada's argument that, because [] per cent of the aircraft being financed are financed without *IQ* equity guarantees, Bombardier's customers are indifferent to *IQ* equity guarantees, and the fees charged by *IQ* in return for the guarantees are market rate. According to Brazil, Canada's logic is flawed, since the fact that [] per cent of the aircraft being financed are financed without *IQ* equity guarantees is irrelevant. Brazil asserts that what matters is the terms of *IQ* equity guarantees in the cases where they are provided, whatever the percentage of those cases is.

7.330 Furthermore, Brazil asserts that *IQ* has provided guarantees with no fees charged and, when it has charged fees, *IQ* uniformly charges a [] per cent fee, regardless of the credit ratings of the airlines involved. According to Brazil, it is hard to trace in this pattern any effort to follow a market. Brazil submits that no market guarantor would charge the same fee to recipients with varying credit ratings.

(b) Evaluation by the Panel

7.331 We shall first address Brazil's argument that *IQ* equity guarantees (also known as "first loss deficiency guarantees")[277] "quintessentially" confer a "benefit" because *IQ* is providing something not available in the market. We shall then address Brazil's broader argument that *IQ* equity guarantees otherwise confer a "benefit" by making equity capital available to finance aircraft transactions on terms more favourable than would be the case in the market absent such guarantees.

(i) Do IQ equity guarantees necessarily confer a "benefit" because equity guarantees are not available in the market?

7.332 We shall begin by examining the factual issue of whether or not equity guarantees (also known as "first loss deficiency guarantees") are available in the market. Only if equity guarantees are not available in the market will we consider whether or not, as a matter of law, the provision by a government of support not available in the market necessarily confers a "benefit".

7.333 As a preliminary matter, we note that the two commercial bank letters submitted by Brazil do not state that equity guarantees are not available in the market. The first letter does not expressly refer to the availability of equity guarantees in the market. [] Thus, while both letters indicate that equity guarantees are "uneconomic", neither letter states categorically that equity guarantees are not available in the market.

[277] We note that, in its request for the establishment of a panel, Brazil claims that "first loss deficiency guarantees", in addition to equity guarantees, provided by *IQ* are prohibited export subsidies (*See* WT/DS222/2).

7.334 We note that Canada has referred to the provision of equity guarantees by certain engine suppliers. Brazil submits that these guarantees were furnished by a participant in the sale, and not by a financial institution in the market. We agree with Brazil that the evidence adduced by Canada regarding the provision of equity guarantees to purchasers of aircraft by companies supplying the engines in the aircraft being purchased does not demonstrate that equity guarantees are available in the market.

7.335 Very late in these proceedings, in response to a question from the Panel at the second meeting, Canada also submitted evidence[278] regarding the existence of a market for financial instruments that transfer risk in a manner similar to the equity guarantees provided by *IQ*. According to Canada, Bombardier has used private sector alternatives in precisely the same manner as *IQ*. []

7.336 Canada submits that, not only is this transaction analogous in structure to *IQ* guarantees, but the position in the financing and size of the [] tranche is identical to that of *IQ* in the vast majority of the latter's transactions. According to Canada, the only significant difference is that while the [] transaction was a [], the *IQ* structure features []. Canada submits that this has the effect of substantially lowering the risk assumed by the insurer (*IQ*).

7.337 Canada also submitted evidence[279] which, in its view, shows that aircraft manufacturers can create innovative financing mechanisms centered around risk and remuneration. []

7.338 Canada has also submitted letters[280] from two financial services institutions, indicating that there is an active private sector market for "risk transfer", the technical term for transactions of this kind. The first institution states that , []. The second institution states that [].

7.339 Brazil asserts that the evidence submitted by Canada does not demonstrate that Embraer would be able to find a guarantee equal to that offered by *IQ* in the market. With respect to the equity guarantee offered by a private insurer to Bombardier, Brazil notes that this guarantee is only for [] percent of the price of the aircraft for [], not the [] per cent for [] Embraer unsuccessfully offered Air Wisconsin, or the [] per cent for [] that Canada provided to Air Wisconsin through *IQ*. Brazil also notes that Canada failed to indicate the premium paid for the insurance, so there is no way to determine how the premium charged for this guarantee compared to the apparent [] per cent premium charged by *IQ*. Brazil asserts that the [] insurance programme only covers an apparent [] per cent effective guarantee through insurance, and notes that the cost of that guarantee has not been disclosed.

7.340 In light of the above, we consider that Canada has adduced sufficient evidence to establish the existence of equity guarantee-like instruments (including first loss deficiency guarantees) in the market. Brazil notes that the instruments identified by Canada have a different duration, and different coverage, than the *IQ* equity guarantees at issue. In our view, however, differences in duration and coverage do not negate a finding that equity guarantee-like instruments are available in the market.[281]

7.341 Given the availability of equity guarantee-like instruments in the market, we find that there is no factual basis to Brazil's claim that *IQ* equity guarantees "quintessentially" confer a "benefit" because *IQ* is providing something that is not available in the market. For this reason, it is not necessary for us to consider whether or not, as a matter of law, the provision by a government of support not available in the market necessarily confers a "benefit".

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[278] *See* Exhibit CAN-74.
[279] *See* Exhibit CAN-75.
[280] *See* Exhibit CAN-76.
[281] Brazil also notes that Canada has not provided any evidence regarding the fees levied for these equity guarantee-like instruments. The question of fees is addressed at paras 7.348-7.357.

(ii) Do IQ equity guarantees otherwise confer a "benefit"?

7.342 In addressing this issue, we must first identify the appropriate method for determining whether or not *IQ* equity guarantees confer a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. We start by recalling the findings of the panel and Appellate Body in *Canada – Aircraft*. In that case, the panel found that

> a financial contribution will only confer a "benefit", *i.e.*, an advantage, if it is provided on terms that are more advantageous than those that would have been available to the recipient on the market.[282]

7.343 The Appellate Body upheld the findings of the panel, ruling that

> 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.[283]

7.344 Consistent with the findings of the panel and Appellate Body in *Canada – Aircraft*, we consider that *IQ* equity guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable than those on which such Bombardier customers could obtain comparable equity guarantees in the market. We note that the parties appear to agree that this standard can be applied by reviewing the fees[284], if any, charged by *IQ* for providing its equity guarantees.[285] We agree that the "benefit" standard could be applied to *IQ* equity guarantees in this manner. Thus, to the extent that *IQ*'s fees are more favourable than fees that would be charged by guarantors with Québec's credit rating in the market for comparable transactions, *IQ*'s equity guarantees may be deemed to confer a "benefit".

7.345 We note Brazil's argument that even if *IQ*'s fees are equal to those charged regional aircraft purchasers by commercial guarantors with A+ credit ratings, under Article 14(c) of the SCM Agreement there would still be a "benefit" as long as there is a difference between the amount the purchaser pays for equity using an *IQ* equity guarantee and the amount it would pay for equity absent the *IQ* equity guarantee. Canada queries the relevance of Article 14(c) in this context, since that provision is concerned with "benefit" in the context of loan guarantees, rather than equity guarantees. In our view, although Article 14(c) is expressly concerned with "benefit" in the context of loan guarantees, there are perhaps sufficient similarities between the operation of loan guarantees and equity guarantees for it to be appropriate to rely on Article 14(c) for the purpose of establishing the existence of "benefit" in the context of equity guarantees in certain circumstances. Thus, a "benefit" could arise if there is a difference between the cost of equity with and without an *IQ* equity guarantee, to the extent that such difference is not covered by the fees charged by *IQ* for providing the equity guarantee. In our opinion, it is safe to assume that such cost difference would not be covered by *IQ*'s fees if it is established that *IQ*'s fees are not market-based.

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[282] *Canada – Aircraft*, Report of the Panel, footnote 35, *supra*, para. 9.112.

[283] *Canada – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 157.

[284] For example, Brazil asserts that, in order to demonstrate that there is no "benefit", Canada would have to prove that *IQ*'s fees are equal to those charged regional aircraft purchasers by commercial guarantors with A+ credit ratings. For its part, Canada (although it rejects Brazil's argument regarding the burden of proof) asserts that there is no "benefit" because the annual fees for *IQ* equity guarantees are market-based.

[285] We note that *IQ* purports to levy both an up-front [] per cent administrative fee, and an annual fee of [] per cent on *IQ*'s effective exposure. We do not understand Brazil to raise any claims regarding the up-front administrative fee. We understand that Brazil's claims are concerned only with the annual fee allegedly levied by *IQ*.

(iii) Burden of proof

7.346 Having established the proper "benefit" test to be applied in respect of *IQ* equity guarantees, we consider it important to clarify which party bears the burden of proof in respect of that standard. Brazil asserts that Canada bears the burden to prove that *IQ* equity guarantees do not confer a "benefit" (by proving that *IQ*'s fees are equal to those charged to regional aircraft purchasers by commercial guarantors with A+ credit ratings). Canada asserts that the burden is on Brazil to prove that *IQ* equity guarantees do confer a benefit.

7.347 It is now well established that the initial burden lies on the complaining party, which must establish a prima facie case of inconsistency. The burden then shifts to the defending party, which must counter or refute the claimed inconsistency.[286] In order to demonstrate that the *IQ* equity guarantees confer a "benefit", the initial burden therefore lies on Brazil, as the complaining party, to demonstrate that any fees levied by *IQ* are more favourable than those that would be charged by equity guarantors in the market. We therefore reject Brazil's argument that, in order to demonstrate that there is no "benefit", Canada would initially have to prove that *IQ*'s fees are equal to those charged regional aircraft purchasers by commercial guarantors with A+ credit ratings.

(iv) Application of the "benefit" standard to specific IQ transactions

7.348 We shall now determine whether or not Brazil has demonstrated that any of the *IQ* equity guarantees at issue confer a "benefit". In this regard, we note Brazil's arguments that *IQ* equity guarantees confer a "benefit" either because they are provided free of charge, or because any fees levied by *IQ* are below market.

No fees charged

7.349 In its oral statement at the Panel's second substantive meeting with the parties, Brazil claimed that *IQ* has provided guarantees with no fees charged, "[a]s [Brazil] will show below in our discussion of specific transactions".[287] Brazil did not indicate precisely which specific transaction(s) it was referring to in this regard. We have carefully reviewed the remainder of Brazil's oral statement, and consider that the only portion that could be interpreted as a claim of *IQ* providing an equity guarantee without charge is [], concerning the [] transaction. Since Brazil has not clearly identified any additional transactions where *IQ* allegedly provided equity guarantees without levying any fee, we shall address Brazil's argument (that *IQ* provides equity guarantees free of charge) by examining whether or not *IQ* charged fees for its equity guarantee to [].[288, 289]

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[286] *See European Communities – Hormones*, Report of the Appellate Body, footnote 45, *supra*.

[287] Oral Statement of Brazil at the Second Meeting of the Panel, para. 23 (Annex A-12).

[288] In its written submission of 20 August 2001, Brazil asserts that for transactions for which Canada has shown evidence of a fee, it has only shown the [] basis point up-front administrative fee, and not the [] basis point annual fee Canada claims is also charged (*See* Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel (Annex A-16)). [].

[289] Oral Statement of Brazil at the Second Meeting of the Panel, para. 110 (Annex A-12). In para. 106 of that submission, Brazil submits that the evidence provided by Canada suggests that *IQ* also provided [], in addition to the equity guarantee. In para. 61 of its 20 August 2001 comments on Canada's 13 August 2001 submission, Brazil notes that Canada does not deny the provision of [] (*See* Comments of Brazil on Responses of Canada to Questions and Additional Questions from the Panel Following the Second Meeting of the Panel (Annex A-16)). While we accept that the documentary evidence presented by Canada appears to indicate the existence of [], Brazil has made no attempt to assert that such [] constitutes a subsidy. Thus, even if *IQ* did provide [], we have no basis on which to make any findings against such []. Brazil has requested adverse inferences regarding *IQ* support to certain airlines (including []) more generally. We address this issue below.

7.350 Brazil claims that, according to the summary of the transaction provided by Canada, *IQ* provided both an equity guarantee and []. According to Brazil, "the fee for the guarantee provided by CQC – [] percent – appears to have been [] for the transaction. Depending on how you look at it, therefore, either the guarantee was provided []. Canada does not respond to this argument.

7.351 The documentary evidence regarding the [] transaction is contained in Exhibit CAN-77.[290] In a table describing the details of the transaction, provision is made for a [] per cent annual fee. [].[291] We are in no doubt – and Canada has not argued – that equity guarantees would not be provided in the market []. Since the *IQ* equity guarantee to [] was therefore provided on terms more favourable than [] could have obtained in the market, we find that the *IQ* equity guarantee to [] confers a "benefit".

Below-market fees

7.352 Brazil asserts that *IQ*'s annual fees are below-market because they are levied uniformly, at [] per cent, regardless of the credit ratings of the airlines involved.

7.353 Canada disagrees, on the basis of []. According to Canada, in large part the risk represented by the possible default of a particular aircraft purchaser is []. Canada asserts that, [], it is entirely appropriate that the fee charged to different purchasers would be the same.

7.354 Brazil raises two counter-arguments. First, Brazil asserts that Bombardier counter-guarantees may well reduce *IQ*'s risk exposure, but they are between Bombardier and *IQ*, and not between Bombardier and the purchaser. []. Second, Brazil asserts that []. Thus, *IQ*'s risk exposure is not diminished with respect to the remaining [] (or []) per cent of its guarantee.

7.355 In support of its argument that uniform fees are necessarily below-market, Brazil asserts that "[n]o market guarantor would charge the same fee to recipients with wildly varying credit ratings".[292] While we agree that market operators would normally charge different equity guarantee fees to customers with different credit ratings, to reflect the different degrees of risk exposure, it is theoretically possible that a uniform fee could be set in such a manner that it covers the risk exposure resulting from the provision of equity guarantees to customers with the lowest credit ratings. For

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Brazil also claims that *IQ* provided financing to Midway, and that Canada has failed to provide full information regarding the terms of the *IQ* equity support to Midway. Brazil therefore requests an adverse inference in respect of the *IQ* equity guarantee to Midway. Canada denies that *IQ* provided financing to Midway, and suggests that Brazil confused the equity guarantee with direct financing. Given Canada's denial, and since we do not see anything in Exhibit CAN-61 that would indicate the existence of *IQ* financing to Midway, we see no basis for Brazil's assertion that *IQ* provided financing to Midway. Furthermore, Brazil has failed to specify why, in its view, Canada has failed to disclose full information regarding the *IQ* equity guarantee to Midway. For our part, we do not see what additional information should have been provided by Canada. We therefore reject Brazil's request for an adverse inference regarding the *IQ* equity guarantee to Midway.

Brazil also asked the Panel to draw an adverse inference regarding *IQ*'s equity guarantee to ACA, again alleging that Canada failed to provide full information regarding the terms of that transaction. We assume that Brazil is referring to the fact that Exhibit CAN-63 does not identify the creditor providing debt financing. In our view, however, the fact that Canada has failed to disclose the identity of the loan creditor has no bearing on the consistency of the *IQ* equity guarantee with the SCM Agreement. We therefore reject Brazil's request for an adverse inference regarding the *IQ* equity guarantee to ACA.

[290] Canada initially submitted details of the first approval of the *IQ* equity guarantee to [] in Exhibit CAN-64. Canada subsequently informed the Panel that the first approval did not reflect the final terms and conditions of *IQ*'s offer, which were then submitted as Exhibit CAN-77.

[291] In response to Question 47 from the Panel, Canada asserted that "*IQ* has charged fees for every transaction in which it has participated and has provided for fees in every financing offer it has made" (Responses of Canada to Questions from the Panel Prior to the Second Meeting of the Panel (Annex B-9)). []

[292] Oral Statement of Brazil at the Second Meeting of the Panel, para. 23 (Annex A-12).

example, if market operators normally charge a two per cent fee to customers with CCC credit ratings, and a 0.25 per cent fee to customers with AAA+ ratings, the levying of a uniform two per cent fee would not necessarily indicate the existence of a "benefit". Instead, a "market" fee would effectively be charged to CCC recipients, while an above-market fee would be charged to AAA+ recipients. For this reason, we are unable to accept Brazil's argument that uniform fees are necessarily below-market.

7.356 Brazil could have sought to establish the existence of a "benefit" by producing evidence to the effect that the levying of a uniform [] fee (on *IQ*'s remaining [] per cent exposure) is not sufficient to cover the risk to which *IQ* is exposed when providing equity guarantees to airlines with the lowest credit ratings. Brazil might have done this, for example, with the assistance of the two financial institutions that provided the letters contained in Exhibit BRA-50. Both financial institutions asserted that the provision of equity guarantees of the sort offered by *IQ* would be uneconomic. In making these assertions, these institutions would presumably have made a preliminary estimation of the nature of the fee that would have to be charged when providing such equity guarantees. This preliminary estimation may have been useful in assessing whether or not the uniform [] fee levied by *IQ* is sufficient to cover the risk exposure resulting from the provision of equity guarantees to airlines with the lowest credit ratings. Brazil presented no such evidence, however. We note that we do not accept Canada's argument that the [] totally eliminate *IQ*'s exposure. Thus, to offer such guarantees on a market basis, *IQ* would still need to concern itself with the credit ratings of the beneficiaries of its guarantees. Nonetheless, it seems clear that the existence of [] would make it possible for *IQ* (or for a commercial bank or insurer) to charge a much lower fee (based on market considerations) than would otherwise be the case. In these circumstances, we cannot conclude that *IQ*'s uniform fee is necessarily a below-market fee for the beneficiaries with the lowest credit ratings. To do so, we would need some evidence of the market fees for these or similar guarantees, and we have none.

7.357 In light of the above, we find that Brazil has failed to establish its claims that the fee-based *IQ* equity guarantees confer a "benefit" and that the levying of a uniform fee for *IQ* equity guarantees necessarily confers a "benefit".

Conclusion

7.358 To conclude, we recall our finding that the *IQ* equity guarantee to Air Nostrum conferred a "benefit", and therefore constituted a subsidy. We also recall our finding that Brazil has failed to establish that the remaining *IQ* equity guarantees at issue conferred a "benefit", and therefore reject Brazil's claims against those remaining *IQ* equity guarantees. In order to determine whether or not the *IQ* equity guarantee to [] is a prohibited export subsidy, we must now consider whether or not it is "contingent … upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

3. Are *IQ* equity guarantees "contingent … upon export performance"?

(a) Arguments of the parties

7.359 Brazil asserts that the *IQ* equity guarantees at issue are both *de jure* and de facto "contingent … upon export performance". Regarding *de jure* export contingency, Brazil relies on the arguments it made in support of its claim that the *IQ* programme "as such" is "contingent … upon export performance".[293] Thus, Brazil refers to Section 25 of the *IQ Act*, which specifies "export activities" as one of the missions of *IQ*. Brazil also refers to *IQ* Decrees 572-2000 and 841-2000. Brazil notes that Decree 572-2000 enables *IQ* to provide financial support for investment projects or export projects, including the sale of goods outside of Québec, and that Decree 841-2000 grants *IQ* the authority to

[293] Second Written Submission of Brazil, para. 148 (Annex A-10).

support market development projects, including projects ultimately focused on the sale of goods outside of Québec.

7.360 Regarding de facto export contingency, Brazil relies on the findings of the *Australia – Leather* panel.[294] Brazil cites para. 9.67 of that panel's report to argue that a Member's awareness that its domestic market is too small to absorb domestic production of a subsidised product indicates the subsidy is granted on the condition that it be exported. In this regard, Brazil notes that [] per cent of Bombardier's regional aircraft have been sold outside of Canada, and that [] per cent of the regional aircraft transactions receiving *IQ* support have been for export outside of Canada.[295]

7.361 Brazil also asserts that Canada failed to provide certain documentation requested by the Panel that would have indicated whether or not the *IQ* equity guarantees at issue were contingent on export. Brazil submits that Canada's failure to provide that documentation should lead the Panel to draw adverse inferences regarding the export contingency of the *IQ* equity guarantees at issue.

7.362 Canada denies that any of the *IQ* equity guarantees at issue are "contingent … upon export performance". In response to Brazil's arguments regarding *de jure* export contingency, Canada asserts that the legal basis for *IQ* financing for aircraft sales is Section 28 – not 25 - of the *IQ Act*. Canada asserts that Section 28 is used for many types of projects, whether or not they have export potential. Canada also asserts that Decrees 572-2000 and 841-2000 have nothing to do with aircraft sales financing and are not used for aircraft sales financing. In any event, Canada asserts that the term "exportation" in Decree 572-2000 refers to the sale of goods outside of Québec, and not outside of Canada.

7.363 Regarding Brazil's claim of de facto export contingency, Canada asserts that Brazil's reference to the panel's finding in *Australia – Leather* is both inaccurate and taken out of context. In particular, Canada considers that Brazil implies incorrectly that the *Australia – Leather* panel considered a Member's awareness that its market could not absorb subsidised domestic production to be sufficient to prove de facto export contingency. In fact, Canada argues, the subsidy in that case was conditioned in part on sales performance targets. Since the Australian government was aware of the fact that the recipient of the subsidy would have to maintain or increase export sales in order to meet those sales performance targets, the panel considered that those sales performance targets were in fact export performance targets. Canada also refers to the *Canada – Aircraft* proceedings, in which the Appellate Body found that it is not sufficient for a complainant alleging de facto export contingency to "demonstrate solely that a government granting a subsidy *anticipated* that exports would result".[296]

7.364 Regarding Brazil's request for adverse inferences, Canada asserts that, to the best of its knowledge, it has provided all of the documentation that exist regarding the review of the *IQ* equity guarantee transactions.

(b) Evaluation by the Panel

7.365 We shall begin by addressing Brazil's claim that the *IQ* equity guarantees at issue are *de jure* "contingent … upon export performance". In this regard, we are guided by the finding of the Appellate Body in *Canada – Autos* that a subsidy is *de jure* conditional on export performance "when

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[294] *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, Report of the Panel, WT/DS126/R, adopted 16 June 1999.

[295] *See* Responses of Canada to Questions 19 and 20 from the Panel, Responses of Canada to Questions from the Panel Following the First Meeting of the Panel (Annex B-7).

[296] *Canada – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 171 (emphasis in original).

the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation, or other legal instrument constituting the measure".[297] Furthermore, in *Canada – Aircraft* the Appellate Body stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'".[298]

7.366 Brazil asserts that the *de jure* export contingency of the *IQ* equity guarantees at issue results from Section 25 of the *IQ Act*, and from Decrees 572-2000 and 841-2000. First, we note Canada's assertion that the legal basis for the guarantees at issue was actually Section 28 of the *IQ Act*, and not Section 25 as initially alleged by Brazil. Brazil appears to have accepted that "*IQ* guarantees to regional aircraft purchasers were issued pursuant to [Section] 28" of the *IQ Act*.[299] Section 28 of the *IQ Act* provides

> The Government may, where a project is of major economic significance for Québec, mandate [*IQ*] to grant and administer the assistance determined by the Government to facilitate the realization of the project. The mandate may authorize the agency to fix the terms and conditions of the assistance.

7.367 We see nothing in the words of Section 28 of the *IQ Act* to suggest that *IQ* equity guarantees based on that provision are *de jure* export contingent. Nor has Brazil argued that Section 28 of the *IQ Act* demonstrates export contingency.[300] [301]

7.368 Regarding Decrees 572-2000 and 841-2000, we note that these legal instruments entered into force in June 2000. With the exception of the Air Wisconsin transaction, all of the *IQ* equity guarantees at issue were provided before June 2000. Furthermore, Brazil itself has asserted that the legal basis for the *IQ* equity guarantee to Air Wisconsin was Decree 1488-2000,[302] and not Decree 572-2000 and / or 841-2000. Since none of the *IQ* equity guarantees at issue were provided on the

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[297] *Canada – Certain Measures Affecting the Automotive Industry* ("*Canada – Autos*"), Report of the Appellate Body, WT/DS139/AB/R-WT/DS142/AB/R, adopted 19 June 2000, para. 100.

[298] *Canada – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 166.

[299] *See* Second Written Submission of Brazil, para. 120 (Annex A-10).

[300] Brazil relies on Section 25 of the *IQ Act* to establish the *de jure* export contingency of *IQ* equity guarantees. Section 25 sets forth the "mission" of *IQ*. Even if *IQ* equity guarantees were provided on the basis of Section 25, we do not consider that Section 25 would necessarily render such guarantees *de jure* export contingent. Brazil has relied on that part of the *IQ* mission dealing with the "[g]rowth of enterprises", described in Section 25 as including "export activities". Without finding that this part of the *IQ* mission would demonstrate *de jure* export contingency, we note that the *IQ* mission set forth in Section 25 also includes, for example, "[s]upport to enterprises", whereby *IQ* "shall also work to retain current investment in Québec by providing support to enterprises established in Québec that show particular dynamism or potential". In our view, there is nothing in the latter description of *IQ*'s mission that would suggest export contingency. Furthermore, even if the *IQ* guarantees at issue were provided on the basis of Section 25, there is nothing to suggest that they were necessarily provided as part of the "[g]rowth of enterprises", rather than "[s]upport to enterprises". We have already stated our view that that part of *IQ*'s mission regarding "[s]upport to enterprises" would not suggest export contingency. Accordingly, even if Section 25 were the legal basis for the *IQ* guarantees at issue, that fact alone would not necessarily mean that they were *de jure* export contingent.

[301] To the extent that para. 131 of the Appellate Body's report on *Canada – Autos* (on the use of domestic over imported goods) requires an examination of the actual operation of a statute to determine whether or not there is *de jure* export contingency, we note that we have found no aspect of the operation of the *IQ Act* in specific transactions that would suggest export contingency (*See* our findings on *de facto* export contingency below).

[302] *See* Second Written Submission of Brazil, paras. 110 and 118 (Annex A-10).

basis of Decrees 572-2000 and / or 841-2000, the wording of those instruments could not render the *IQ* equity guarantees at issue *de jure* export contingent.[303]

7.369 For these reasons, we find that the *IQ* equity guarantees at issue are not *de jure* "contingent … upon export performance".

7.370 In addressing Brazil's de facto export contingency claim, we shall be guided by note 4 to Article 3.1(a) of the SCM Agreement, whereby a subsidy is "contingent … in fact … upon export performance" 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.

7.371 Brazil's de facto export contingency claim is based on its interpretation of the findings of the *Australia – Leather* panel. That panel found that

> the Australian market for automotive leather is too small to absorb Howe's production, much less any expanded production that might result from the financial benefits accruing from the grant payments, and the required capital investments, which were to be specifically for automotive leather operations.* Therefore, we conclude that, in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports. At the time the contract was entered into, the government of Australia was aware of this necessity, and thus anticipated continued and possibly increased exports by Howe. In our view, these facts effectively transform the sales performance targets into export performance targets. We thus consider that Howe's anticipated export performance was one of the conditions for the grant of the subsidies. Australia argues that this consideration would lead to a result that would penalize small economies, where firms are often dependent on exports in order to achieve rational economic levels of production. Nevertheless, in the specific circumstances of this case, we find this consideration compelling evidence of the close tie between anticipated exportation and the grant of the subsidies.[304] (* footnote omitted)

7.372 According to the *Australia – Leather* panel, therefore, in certain circumstances (in the presence of export performance targets, for examples) a Member's awareness that its domestic market is too small to absorb domestic production of a subsidised product may indicate that the subsidy is granted on the condition that it be exported. In this regard, we note that *IQ* was very likely aware that the Canadian domestic market was too small to absorb Bombardier production, because [] per cent of Bombardier's regional aircraft have been sold outside of Canada, and [] per cent of the regional aircraft transactions receiving *IQ* support have been for export outside of Canada.

7.373 However, in *Canada – Aircraft*, the Appellate Body stated that

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[303] In the context of Brazil's claim against the *IQ* programme "as such", the parties disagreed as to whether or not Decrees 572-2000 and 841-2000 could be used for providing *IQ* support for regional aircraft transactions. Since Decrees 572-2000 and 841-2000 are not relevant to the *IQ* equity guarantees at issue, we do not consider it necessary to resolve this issue.

[304] *Australia – Leather*, Report of the Panel, footnote 294, *supra*, para. 9.67.

> 169. … satisfaction of the standard for determining *de facto* export contingency set out in footnote 4 requires proof of three different substantive elements: first, the "*granting* of a subsidy"; second, "is … *tied to* …"; and, third, "actual or anticipated exportation or export earnings". (emphasis added) We will examine each of these elements in turn.
>
> 170. The first element of the standard for determining *de facto* export contingency is the "*granting* of a subsidy". In our view, the initial inquiry must be on whether the *granting authority* imposed a condition based on export performance in providing the subsidy. …
>
> 171. The second substantive element in footnote 4 is "tied to". The ordinary meaning of "tied to" confirms the linkage of "contingency" with "conditionality" in Article 3.1(a). Among the many meanings of the verb "tie", we believe that, in this instance, because the word "tie" is immediately followed by the word "to" in footnote 4, the relevant ordinary meaning of "tie" must be to "limit or restrict as to … conditions".* This element of the standard set forth in footnote 4, therefore, emphasises that a relationship of conditionality or dependence must be demonstrated. The second substantive element is at the very heart of the legal standard in footnote 4 and cannot be overlooked. In any given case, the facts must "demonstrate" that the granting of a subsidy is *tied to* or *contingent upon* actual or anticipated exports.* It does *not* suffice to demonstrate solely that a government granting a subsidy *anticipated* that exports would result. The prohibition in Article 3.1(a) applies to subsidies that are *contingent* upon export performance.
>
> 172. We turn now to the third substantive element provided in footnote 4. The dictionary meaning of the word "anticipated" is "expected".* The use of this word, however, does *not* transform the standard for "contingent … in fact" into a standard merely for ascertaining "expectations" of exports on the part of the granting authority. Whether exports were anticipated or "expected" is to be gleaned from an examination of objective evidence. This examination is quite separate from, *and should not be confused with*, the examination of whether a subsidy is "tied to" actual or anticipated exports. A subsidy may well be granted in the knowledge, or with the anticipation, that exports will result. Yet, that alone is not sufficient, because that alone is not proof that the granting of the subsidy is *tied to* the anticipation of exportation.
>
> 173. There is a logical relationship between the second sentence of footnote 4 and the "tied to" requirement set forth in the first sentence of that footnote. The second sentence of footnote 4 precludes a panel from making a finding of *de facto* export contingency for the sole reason that the subsidy is "granted to enterprises which export". In our view, merely knowing that a recipient's sales are export-oriented does not demonstrate, without more, that the granting of a subsidy is tied to actual or anticipated exports. The second sentence of footnote 4 is, therefore, a specific expression of the requirement in the first sentence to demonstrate the "tied to" requirement. We agree with the Panel that, under the second sentence of footnote 4, the export orientation of a recipient may be taken into account as *a* relevant fact, provided that it is one of several facts which are considered and is not the only fact supporting a finding. (* footnotes omitted)

7.374 Thus, even if a Member were to anticipate that exports would result from the grant of a subsidy (because, for example, of the export-orientation of the recipient), the Appellate Body has made it clear that such anticipation "alone is not proof that the granting of the subsidy is *tied to* the anticipation of exportation" within the meaning of note 4 to Article 3.1(a).

7.375 In upholding the findings of the *Canada – Aircraft* panel, the Appellate Body noted that

> the Panel took into account sixteen different factual elements, which covered a variety of matters, including: TPC's statement of its overall objectives; types of information called for in applications for TPC funding; the considerations, or eligibility criteria, employed by TPC in deciding whether to grant assistance; factors to be identified by TPC officials in making recommendations about applications for funding; TPC's record of funding in the export field, generally, and in the aerospace and defence sector, in particular; the nearness-to-the-export-market of the projects funded; the importance of projected export sales by applicants to TPC's funding decisions; and the export orientation of the firms or the industry supported.[305]

7.376 On a general level, a number of the factors identified by the Appellate Body may be relevant in the present case, particularly in respect of *IQ*'s "overall objectives",[306] *IQ*'s "record of funding in the export field", "the nearness-to-the-export-market of the projects funded", and "the export orientation of the firms or the industry supported". In considering "the nearness-to-the-export-market of the projects funded", we note the Appellate Body's statement that "[i]f a panel takes this factor into account, it should treat it with considerable caution. In our opinion, the mere presence or absence of this factor in any given case does not give rise to a presumption that a subsidy is or is not *de facto* contingent upon export performance".[307] In considering "the export orientation of the firms or the industry supported", we recall the Appellate Body's finding that a Member's awareness that the grant of a subsidy may result in exports – because, for example, of the export orientation of the recipient firm or industry – "alone is not proof that the granting of the subsidy is *tied to* the anticipation of exportation" within the meaning of note 4 to Article 3.1(a).

7.377 With regard to the "overall objectives" of *IQ*, and its "record of funding in the export field", we see important differences between the operation of the TPC programme and the operation of the *IQ* programme. In particular, we note that TPC employees were required to focus on the volume of export sales resulting directly from the project. There is no evidence to suggest that this was the case in respect of *IQ* support. In addition, TPC Business Plans recorded the proportion of the aerospace and defence industry's revenue allocable to exports. Again, there is nothing to suggest that *IQ* focused on the proportion of revenue allocable to exports. Furthermore, while the 1996-1997 TPC Annual Report stated that "[t]he 12 largest firms [in the A&D sector] account for most of the R&D and shipments, of which 80 per cent are exported",[308] only [] per cent of total *IQ* support has directly or indirectly concerned Bombardier regional aircraft (all of which were exported outside of Canada).[309] In other words, while TPC was clearly operated in a way that suggests that TPC support was "tied to" anticipated exports, there is no evidence in the record to suggest that *IQ* is operated in a similar manner.

7.378 In light of the above, we are not persuaded that *IQ* equity guarantees are *de facto* export contingent.[310]

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[305] *Canada – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 175.

[306] We note that part of *IQ*'s mission is to "participate in the growth of enterprises, in particular by facilitating research and development and export activities" (Section 25, *IQ Act* (Exhibit BRA-18)).

[307] *Canada – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 174.

[308] *Canada – Aircraft*, Report of the Panel, footnote 35, *supra*, para. 9.340.

[309] *See* Response of Canada to Questions 18 and 19 from the Panel, Responses of Canada to Questions from the Panel Following the First Meeting of the Panel (Annex B-7).

[310] We recall that, according to footnote 4 to Article 3.1(a) of the SCM Agreement, "[t]he mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy".

7.379 Brazil has also asked the Panel to draw adverse inferences regarding the alleged export contingency of the *IQ* equity guarantees at issue. Brazil's request is based on the alleged failure by Canada to provide all the documentation requested by the Panel in its Question 14 to Canada, dated 29 June 2001. Question 14 reads:

> Brazil has identified a number of *IQ* transactions in paragraphs 90 and 91 of its first written submission. Canada has not denied that *IQ* was involved in any of these transactions. Please provide full details of the terms and conditions of these transactions. Please also provide all documentation regarding the review of these transactions by *IQ*. Please also provide the credit ratings of the relevant airlines at the time of these transactions.

7.380 In its response to Question 14, Canada asserted that *IQ* has been involved with only two of the Bombardier customers identified by Brazil in its first written submission. Canada informed the Panel of three additional airlines, not identified by Brazil, to which *IQ* had provided equity guarantees. While Canada provided details of the terms and conditions of these *IQ* transactions, it failed to provide any "documentation regarding the review of these transactions by IQ". Accordingly, on 20 July 2001, we addressed the following Question 41 to Canada:

> Please provide the documentation requested in Question 14 from the Panel, particularly in respect of the specific guarantee fees involved, [], or explain why such documentation is not available.
>
> In addition, please provide all documentation regarding the review by *IQ* of the Air Littoral, Atlantic Coast Airlines and Air Nostrum transactions referred to in Canada's response to Question 14 from the Panel.

7.381 In its response to our Question 41, Canada provided documentary evidence regarding *IQ*'s review of the relevant transactions. Subsequently, in response to Question 71 from the Panel, Canada informed us that the documentation it provided in respect of the *IQ* equity guarantee to Air Nostrum did not reflect the final terms and conditions of that guarantee. It therefore submitted documents regarding the final terms and conditions, apologising for the "error" and stating that it "was not previously aware of the existence of the second set of documents for this transaction". In response to Question 72 from the Panel, Canada then asserted that, "[t]o the best of its knowledge, Canada has provided all of the documentation that exists regarding the review of these transactions by IQ".

7.382 Brazil made the following comment on Canada's response to Question 72 from the Panel:

> In its response to Question 72, Canada states that it "has provided all of the documentation that exists" regarding IQ's review of the Mesa, Midway, Air Littoral, Atlantic Coast Airlines, and Air Nostrum transactions. This response is highly suspect in light of the conflicting answers and documentation that Canada has produced to the Panel involving the Air Nostrum sale. Brazil asks the Panel to consider the following points.
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> On 29 June 2001, the Panel asked Canada, in Question 14, to "provide full details of the terms and conditions" of IQ's support for certain aircraft sales, and "all documentation regarding the review of these transactions by IQ." On 6 July 2001, Canada responded, in part, by firmly stating that IQ was only involved in the Air Nostrum deal to the extent that it provided an "'equity guarantee' of up to a maximum of []% of the aircraft purchase price." However this statement conflicts with the summary of the Air Nostrum transaction that appears in Exhibit [CAN]-64, a document that Canada withheld until 26 July 2001.

> Exhibit [CAN]-64 contains [].
>
> Instead of disclosing to the Panel this discrepancy, Canada now simply states that Exhibit [CAN]-64 "did not reflect the final terms and conditions of the guarantee provided by IQ". Instead, in response to Question 71, Canada now provides a new document, Exhibit [CAN]-77, dated 18 June 1998. Canada states that this document contains IQ's "final recommendation and transaction summary" for Air Nostrum. The "Détails du Financement" chart provided with Exhibit [CAN]-77 indicates that the percentages contained in Exhibit [CAN]-64 have changed. [].
>
> Although the percentages and terms contained in Exhibit [CAN]-77 differ from Exhibit [CAN]-64 only slightly, Brazil notes that they differ significantly from those in Canada's response to Question 14. More importantly, however, the appearance of Exhibit [CAN]-77 at this late stage in this dispute is extremely troubling, and casts a cloud on Canada's statement that "it has provided all of the documentation that exists regarding the review" of this and other transactions by IQ. Canada states that it "was not previously aware of the existence" of Exhibit [CAN]-77. If this is true, then one must question whether the documents that Canada has provided regarding IQ do, in fact, represent IQ's final recommendations for the Mesa, Midway, Air Littoral, Atlantic Coast Airlines, and Air Nostrum transactions. This is particularly true in light of Canada's initial statement in response to Question 14 that IQ only provided an "equity guarantee" to Air Nostrum. Brazil therefore asks the Panel to take adverse inferences and presume that other documents exist that show that subsidies contingent on export have been granted.

7.383 We understand Brazil's request for adverse inferences to be based on two considerations. *First*, because Canada failed to disclose the provision of *IQ* financing to Air Nostrum. *Second*, because of doubts as to whether Canada has submitted the final recommendations regarding the *IQ* equity guarantees to Mesa Air Group, Midway, Air Littoral, ACA and Air Nostrum.

7.384 Regarding the first point, we note that the request we addressed to Canada in our Question 14, and which we repeated in Question 41, did not specifically include *IQ* financing. Our requests referred to the *IQ* transactions identified by Brazil in paragraphs 90 and 91 of its first written submission, which only concerned equity guarantees. Thus, although one might have hoped that Canada would be more forthcoming,[311] Canada was not required to provide details of *IQ* financing in order to respond fully to Questions 14 and 41.[312] Furthermore, we do not understand Canada to have

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[311] In this regard, we note Article 3.10 of the DSU which enjoins Members of the WTO, if a dispute arises, to engage in dispute settlement procedures "in good faith in an effort to resolve the dispute". As the Appellate Body has previously stated, the "procedural rules of WTO dispute settlement are designed to promote, not the development of litigation techniques, but simply the fair, prompt and effective resolution of trade disputes" (*United States – Tax Treatment of "Foreign Sales Corporations*", Report of the Appellate Body, WT/DS108/AB/R, adopted 20 March 2000, para. 166).

[312] Strictly speaking, our request for documentation was limited to the *IQ* transactions identified by Brazil in its first written submission. Nevertheless, in responding to our question, Canada also referred to three additional *IQ* transactions not identified by Brazil in its first written submission. That being said, we regret that it was necessary for us to address a second request for documentary evidence to Canada, in the form of Question 41 from the Panel (*See* Responses of Canada to Questions from the Panel Prior to the Second Meeting of the Panel (Annex B-9)). Canada has offered no explanation as to why such documentary evidence, which was not supplied with respect to those transactions identified by the Panel or with respect to additional transactions revealed by Canada, could not have been included in its initial response to Question 14 from the Panel (*See* Responses of Canada to Questions from the Panel Following the First Meeting of the Panel (Annex B-7)). We do believe, however, that it was appropriate for us to request the documentation a second

stated that *IQ* "only" provided an equity guarantee to Air Nostrum. While Canada stated that *IQ* had provided an equity guarantee to Air Nostrum, it did not exclude the possibility that other forms of *IQ* support had also been provided. Again, Canada's response to our questions, which were based on Brazil's first written submission, did not require it to disclose the existence of *IQ* financing to Air Nostrum.

7.385 Regarding the second point, we are not persuaded that an "error" on the part of Canada regarding the final terms and conditions of the *IQ* equity guarantee to Air Nostrum should cause us to doubt whether Canada has provided details of the final terms and conditions of the *IQ* equity guarantees to Mesa Air Group, Midway, Air Littoral, ACA and Air Nostrum. Canada has assured us that "[t]o the best of its knowledge, Canada has provided all of the documentation that exists regarding the review of these transactions by *IQ*". We see no reason to doubt Canada's assurance.

7.386 In light of the above, we do not consider it appropriate to draw the inference requested by Brazil.

4. Conclusion

7.387 To conclude, while we find that the *IQ* equity guarantee to [] is a subsidy, we find that it is neither *de jure* nor de facto "contingent … upon export performance", within the meaning of Article 3.1(a) of the SCM Agreement. Accordingly, we reject Brazil's claim that the *IQ* equity guarantee to [] is a prohibited export subsidy.

7.388 Since we have found that the remaining *IQ* equity guarantees at issue do not confer a "benefit", we also reject Brazil's Article 3.1(a) claims against those measures.

I. *IQ* LOAN GUARANTEES

7.389 Brazil has made claims against loan guarantees provided by *IQ* to Mesa Air Group (September 1998 and December 1999), and to the EDC in respect of the Air Wisconsin transaction (December 2000).

(a) Arguments of the parties

7.390 Brazil asserts that loan guarantees are *per se* prohibited by item (j) to the Illustrative List of Export Subsidies.[313] An *IQ* loan guarantee constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) and (iii) of the SCM Agreement. An *IQ* loan guarantee confers a benefit by substituting a superior governmental credit rating for a borrower's inferior credit rating. The loan guarantee confers a "benefit" by enabling an airline to borrow funds based upon the credit rating of the Government of Québec, which is A+ or A2. To demonstrate that the *IQ* loan guarantees at issue are "contingent … upon export performance", Brazil invokes the same arguments that it relied on in respect of the abovementioned *IQ* equity guarantees.

7.391 Canada acknowledges that *IQ* loan guarantees constitute "financial contributions". In particular, they constitute potential direct transfers of funds or liabilities within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. In particular Canada denies that the *IQ* loan guarantees at issue confer a "benefit", however, because *IQ* charges market-based fees for those loan guarantees. Canada rejects Brazil's claim that *IQ* loan guarantees are "contingent … upon export performance", for the same reasons as Canada denied the export contingency of *IQ* equity guarantees.

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time, rather than simply reject Canada's answer as incomplete or unresponsive, as Brazil seemed to suggest we should do.

[313] *See* Second Written Submission of Brazil, para. 112 (Annex A-10).

(b) Evaluation by the Panel

7.392 We shall first examine whether or not *IQ* loan guarantees are "financial contributions" that confer a "benefit". If, as a result, we find that *IQ* loan guarantees constitute subsidies, we shall then consider whether or not such subsidies are "contingent … upon export performance" within the meaning of Article 3.1(a).

7.393 We note that Canada acknowledges that *IQ* loan guarantees constitute "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. We agree and there is therefore no need for us to examine this matter further.[314]

7.394 Brazil argues that loan guarantees are *per se* prohibited by item (j) to the Illustrative List of Export Subsidies. Item (j) provides:

> (j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

7.395 In our view, item (j) sets out the circumstances in which the grant of loan guarantees is *per se* deemed to be an export subsidy (i.e., when the "premium rates … are inadequate to cover the long-term operating costs and losses" of the loan guarantee). Item (j) certainly does not provide, as alleged by Brazil, that all loan guarantees are *per se* prohibited by item (j). Since Brazil has made no attempt to argue that the *IQ* loan guarantees at issue were provided "at premium rates which are inadequate to cover the long-term operating costs and losses" thereof, we make no findings against the *IQ* loan guarantees at issue on the basis of item (j) of the Illustrative List of Export Subsidies.[315]

7.396 Brazil also asserts that the *IQ* loan guarantees at issue necessarily confer a "benefit" by enabling the relevant airlines to borrow funds based upon the superior credit rating of the Government of Québec, which is A+ or A2. This argument essentially means that any government loan guarantee necessarily confers a "benefit" (since the very purpose of a government loan guarantee is to make available the superior credit rating of the government concerned). We are unable to accept this argument, since it ignores the clear distinction made in Article 1.1 of the SCM Agreement between a "financial contribution" and a "benefit".[316] The term "benefit" relates to the effects of a "financial contribution". Thus, in order to demonstrate the existence of a "benefit", a complaining party must do more than establish the existence of a "financial contribution".

7.397 In considering precisely what Brazil must show in order to demonstrate the existence of a "benefit", we note the findings of the panel and Appellate Body in *Canada – Aircraft*. We therefore consider that *IQ* loan guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable that those on which such Bombardier customers could obtain comparable loan guarantees in the market. In applying this standard, we are guided by Article 14(c) of the SCM Agreement, which provides contextual guidance for interpreting the term

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[314] In particular, there is no need for us to consider whether or not *IQ* loan guarantees constitute the provision of "goods or services other than general infrastructure" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement, as alleged by Brazil.

[315] We also note that neither party has sought to rely on an *a contrario* reading of item (j) for the purpose of demonstrating, or refuting, the existence of "benefit".

[316] Brazil's argument also ignores the terms of Article 14(c), which explains the circumstances in which government loan guarantees "shall not be considered as conferring a benefit" in the context of countervailing duty investigations. If all government loan guarantees necessarily conferred a "benefit", as argued by Brazil, the Article 14(c) guideline would be meaningless.

"benefit" in the context of loan guarantees.[317] Article 14(c) provides that, for the purpose of calculating the amount of a subsidy in terms of the "benefit" to the recipient (for the purpose of a countervailing duty investigation):

> (c) a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees;

7.398 In our view, and taking into account the contextual guidance afforded by Article 14(c), we consider that an *IQ* loan guarantee will confer a "benefit" when "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by [*IQ*] and the amount that the firm would pay on a comparable commercial loan absent the [*IQ*] guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees". In other words, there will be a "benefit" when the cost-saving for a Bombardier customer for securing a loan with an *IQ* loan guarantee is not offset by *IQ*'s fees. In our opinion, it is safe to assume that this will be the case if it is established that *IQ*'s fees are not market-based.

7.399 In applying this "benefit" test to the two *IQ* loan guarantees at issue, we note Brazil has made no arguments to the effect that "there is a difference between the amount that the [Mesa Air Group] pays on a loan guaranteed by [*IQ*] and the amount that the [Mesa Air Group] would pay on a comparable commercial loan absent the [*IQ*] guarantee", adjusted for any difference in fees. In particular, although Brazil does not deny that loan guarantees are available on a commercial basis, Brazil has failed to adduce any arguments or information regarding what Mesa Air Group might have had to pay on a comparable commercial loan absent the *IQ* loan guarantee.[318] Nor has Brazil made any other argument to the effect that *IQ*'s fee for its loan guarantee to Mesa Air Group is not market-based. Accordingly, we reject Brazil's claim that the *IQ* loan guarantee to Mesa Air Group confers a "benefit".

7.400 Regarding the *IQ* loan guarantee to the EDC in respect of the Air Wisconsin transaction, Brazil has asserted (in a letter dated 3 September 2001, commenting on certain documentary evidence submitted by Canada at the request of the Panel) that *IQ* "charged [] for this guarantee". As noted above, it is safe to assume that there is "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee", adjusted for any differences in fees, if the relevant fees are not market-based. There is no doubt that a fee of [] is not market-based, because a market operator would not provide a loan guarantee [].

7.401 [] In fact, the evidence before us suggests that the *IQ* loan guarantee to the EDC is []. In a table summarising the equity and loan guarantees to be provided by *IQ* in respect of the Air Wisconsin transaction, [].

7.402 In light of the evidence before us, which suggests that the *IQ* loan guarantee for the Air Wisconsin transaction is [], and in light of the contextual guidance afforded by Article 14(c) of the SCM Agreement, we find that the *IQ* loan guarantee to the EDC for the Air Wisconsin transaction

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[317] *See Canada – Aircraft*, Report of the Appellate Body, footnote 35, *supra*, para. 155, regarding the contextual relevance of Article 14 for the purpose of determining the existence of "benefit".

[318] We recall that the initial burden lies on the complaining party to establish a *prima facie* case of inconsistency (*See* para. 7.75, *supra*).

confers a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement, and therefore constitutes a subsidy.

7.403 In order to determine whether or not the *IQ* loan guarantee for the Air Wisconsin transaction constitutes a prohibited export subsidy, we must consider whether or not the loan guarantee is "contingent … upon export performance". We note that Brazil's claim regarding the export contingency of *IQ* loan guarantees is based on the same arguments as those advanced in support of its claim regarding the export contingency of *IQ* equity guarantees. Since we have already found that Brazil's arguments do not demonstrate that the *IQ* equity guarantees at issue in these proceedings are "contingent … upon export performance", we are compelled to make the same finding in respect of *IQ*'s loan guarantees. Accordingly, we find that the *IQ* loan guarantee to the EDC for the Air Wisconsin transaction is not "contingent … upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

(c) Conclusion

7.404 We find that the *IQ* loan guarantee to Mesa Air Group is not a subsidy, since it does not confer a "benefit" within the meaning of Article 1.1(b). We find that the *IQ* loan guarantee to Air Wisconsin is a subsidy, but that it is not "contingent … upon export performance". For these reasons, we reject Brazil's claim that the *IQ* loan guarantees to Mesa Air Group and Air Wisconsin constitute prohibited export subsidies, contrary to Article 3.1(a) of the SCM Agreement.

VIII. CONCLUSIONS AND RECOMMENDATION

8.1 In conclusion, we:

(a) reject Brazil's claim that the EDC Corporate Account and Canada Account programmes "as such" constitute prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement;

(b) reject Brazil's claim that the *IQ* programme "as such" constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;

(c) reject Brazil's claim that the EDC Corporate Account and Canada Account programmes "as applied" constitute prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement;

(d) reject Brazil's claim that the *IQ* programme "as applied" constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;

(e) uphold Brazil's claim that the EDC Canada Account financing to Air Wisconsin constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;

(f) uphold Brazil's claim that the EDC Canada Account financing to Air Nostrum constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;

(g) uphold Brazil's claim that the EDC Corporate Account financing to Comair in July 1996, August 1997 and February 1999 constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;

(h) reject Brazil's claim that the EDC Corporate Account financing to ASA, ACA, Kendell Air Nostrum and Comair in December 1996, March 1997 and March 1998 constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement;

(i) reject Brazil's claim that *IQ* equity guarantees to ACA, Air Littoral, Midway, Mesa Air group, Air Nostrum and Air Wisconsin constitute prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement; and

(j) reject Brazil's claim that *IQ* loan guarantees to Mesa Air Group and Air Wisconsin constitute prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement.

8.2 Pursuant to Article 3.8 of the DSU, the findings in sub-paragraphs (e), (f) and (g) of the preceding paragraph also constitute a case of *prima facie* nullification or impairment of benefits accruing to Brazil under the SCM Agreement, which Canada has not rebutted.

8.3 In light of the above findings, we are required to make the recommendation provided for in Article 4.7 of the SCM Agreement. Accordingly, we recommend that Canada withdraw the subsidies identified above without delay.

8.4 Article 4.7 further provides that "the panel shall specify in its recommendation the time-period within which the measure must be withdrawn." In other words, we are required to specify what period would represent withdrawal "without delay". Taking into account the procedures that may be required to implement our recommendation on the one hand, and the requirement that Canada withdraw its subsidies "without delay" on the other, we conclude that Canada shall withdraw the subsidies identified in sub-paragraphs (e), (f), and (g) of paragraph 8.1 within 90 days.

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ANNEX A

Submissions of Brazil

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ANNEX A-1

RESPONSE OF BRAZIL TO COMMUNICATION OF 16 MAY 2001 FROM CANADA TO BRAZIL

(21 May 2001)

In a letter to the Panel dated 16 May 2001, Canada requested that Brazil provide "confirmation" and "clarification" on a number of points concerning Brazil's challenge to several Canadian subsidies. In accordance with normal practice in the WTO, Brazil intends to present its position to the Panel, to Canada, and to the Third Parties, in its first written submission to the Panel at the time established by the Panel in its Working Procedures.

ANNEX A-2

COMMUNICATION OF 21 MAY 2001 FROM BRAZIL TO THE PANEL

(21 May 2001)

1. With this letter, Brazil requests that the Panel exercise its discretion, under Article 13.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), to request from Canada documents and other information concerning the terms of any support from 1 January 1995 onward committed or granted by the Export Development Corporation ("EDC"), Canada Account, Investissement Québec ("IQ"), or any subsidiary organizations thereof, in connection with the sale of regional aircraft by Bombardier, the Canadian manufacturer. As you are aware from its request for establishment of this Panel, Brazil considers that Canadian support for its regional aircraft industry under these programs, each of which was challenged in *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*")[1], constitutes prohibited export subsidies. A recent transaction involving Air Wisconsin, discussed below, is but one example of this support.

2. This request is necessitated by Canada's refusal to produce evidence that is solely within its possession, and that is necessary to the Panel's assessment of this dispute. Later in this letter, Brazil will present evidence available from public sources establishing a *prima facie* case that Canada Account support for the Air Wisconsin transaction, and EDC and IQ support for the Canadian regional aircraft industry, constitutes a prohibited export subsidy. In subsequent submissions, Brazil will provide additional evidence supporting its claims, both with respect to the Air Wisconsin transaction and other deals. However, given the confidential nature of regional aircraft transactions[2], the only direct evidence available – documents concerning the terms of Canadian government support for regional aircraft transactions – is in the sole possession of the Canadian government.

Canada's refusal to produce information

3. Canada's repeated failure to provide highly relevant evidence within its sole possession is well-documented. In the *Canada – Aircraft* dispute, Canada refused, in consultations with Brazil, to provide documentary information regarding support under the very same programs at issue in this dispute.[3] Moreover, the Report of the Panel in that dispute includes 26 citations to Canada's refusal to provide specific documentary information requested not by Brazil, but by the Panel itself, with respect once again to the very same programs challenged in the current dispute.[4]

4. This pattern appears to be repeating itself in these proceedings. In consultations with Canada on 21 February 2001, Brazil affirmatively requested transaction-specific information about the details

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[1] WT/DS70/R (14 April 1999) (Adopted 20 August 1999).

[2] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/R (14 April 1999) (Adopted 20 August 1999), para. 7.27 (Panel notes that regional aircraft transactions involve "confidential business information not generally available to the public at large.").

[3] WT/DS70/R, para. 4.80.

[4] WT/DS70/R, paras. 6.80, 6.171, 6.203, 6.258, 6.259, 6.260, 6.279, 6.303, 6.304, 6.326, 6.327, 9.176, 9.188, 9.218, 9.244, 9.253, 9.272, 9.293, 9.294, 9.299, 9.303, 9.313, 9.314 (note 621), 9.327, 9.345, 9.347 (note 633).

of EDC, Canada Account and IQ support for Canadian regional aircraft industry transactions.[5] Other than a statement that support for one transaction – the Air Wisconsin deal – would "probably" be through the Canada Account, Canadian representatives at the consultations refused to produce any such information.[6]

5. Canada's failure to provide this information to Brazil during consultations is directly contrary to its legal obligations. Tribunals in a variety of public international law fora have long recognised that governments party to international disputes have a particular responsibility to provide documents within their exclusive control.[7] Indeed, in *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India – Pharmaceuticals*"), the Appellate Body specifically recognised that all Members are required to be "fully forthcoming" at all stages of WTO dispute settlement proceedings, noting that:

> All parties engaged in dispute settlement under the DSU must be fully forthcoming from the very beginning both as to the claims involved in a dispute and as to the facts relating to those claims. . . . This must be so in consultations as well as in the more formal setting of panel proceedings.[8]

Canada's failure to provide information requested by Brazil in consultations in this dispute is in direct contravention of these requirements.

The Panel's unconditional authority to request information

6. In its Report in *Canada – Aircraft*, the Appellate Body confirmed both the authority of a panel, under Article 13.1 of the DSU, to request information from whomever it likes, whenever it likes, and the legal obligation of a Member to comply with the panel's request.[9] According to the Appellate Body, "Article 13.1 imposes *no conditions* on the exercise of [a panel's] discretionary authority."[10] Moreover, in its Report in *India – Pharmaceuticals*, the Appellate Body specifically advised Members to call upon a panel's authority to request information when evidence necessary to a panel's consideration is not produced in consultations:

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[5] Brazil attaches its list of consultation questions to Canada as Exhibit Bra-1.

[6] EDC officials have publicly stated that they will not provide "financing details" for the Air Wisconsin transaction. "Bombardier Snags $2.4 B order from U.S. airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001 (Exhibit Bra-2).

[7] *See, e.g.*, Mexico/USA General Claims Commission, *William A. Parker (USA) v. United Mexican States*, *IV Recueil des Sentences Arbitrales* 35, 39 (31 March 1926) ("In any case where evidence which would probably influence its decision is peculiarly within the knowledge of the claimant or of the respondent Government, the failure to produce it, unexplained, may be taken into account by the Commission in reaching its decision."); Charles N. Brower, *The Anatomy of Fact-Finding before International Tribunals: An Analysis and a Proposal Concerning the Evaluation of Evidence*, *in* FACT-FINDING BEFORE INTERNATIONAL TRIBUNALS 147, 150-151 (R. Lillich, Ed., 1991) (Judge Brower of the Iran-United States Claims Tribunal perceives "the emergence of a *lex evidentia* that will embrace common principles for the evaluation of evidence by international tribunals," including the principle that, "[w]hen it reasonably should be expected that certain evidence exists and that it is in the control of a party, the failure of that party to produce such evidence gives rise to a justifiable inference that such evidence, if produced, would be adverse to that party."); Durward V. Sandifer, EVIDENCE BEFORE INTERNATIONAL TRIBUNALS (Rev. Ed., Univ. Press of Virginia 1975) 112 ("[P]arties to international judicial proceedings have a more extensive obligation to produce all evidence within their control than that normally imposed upon litigants in municipal proceedings.").

[8] WT/DS50/AB/R (19 December 1997) (Adopted 16 January 1998), para. 94.

[9] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999), para. 189.

[10] WT/DS70/AB/R, para. 185.

> If, in the aftermath of consultations, any party believes that all the pertinent facts relating to a claim are, for any reasons, not before the panel, then that party should ask the panel in that case to engage in additional fact-finding.[11]

Finally, Article 11 of the DSU requires a panel to make "an objective assessment of the matter before it".

7. Action by the Panel at this stage is fully justified by Canada's failure to observe the requirement to be "fully forthcoming" in consultations with Brazil, in the words of the Appellate Body in *India – Pharmaceuticals*. Canada's failure to provide evidence solely within its possession is not without effect; it has directly caused (and will continue to cause) the absence of "pertinent facts" necessary to the Panel's consideration of this case. Only direct evidence of Canadian support for its regional aircraft industry – evidence that is, once again, solely in Canada's possession – can resolve this matter definitively. In these circumstances, so that the Panel may effectively discharge its duty to make "an objective assessment of the matter before it," under DSU Article 11, it is both "necessary and appropriate", within the meaning of DSU Article 13.1, for the Panel to engage in the "additional fact-finding" discussed by the Appellate Body in *India – Pharmaceuticals*, and to request documentary information regarding EDC, Canada Account and IQ support for Canadian regional aircraft transactions, including the Air Wisconsin deal.

Confidentiality

8. The Appellate Body concluded that a panel's authority to request information under Article 13.1 of the DSU is unconditional. In *Canada – Aircraft*, however, Canada argued that compliance with a panel's request under Article 13.1 was conditional. Canada argued that it could not comply with the Panel's request for the production of documentary evidence in this case because it objected to an amendment the Panel had made to Canada's proposed confidentiality procedures.[12] The Appellate Body rejected Canada's claim that objections to the confidentiality procedures justified a refusal to provide the documentary information requested by the Panel.[13]

Prima facie case

9. Canada also claimed that the Panel's authority to request information was limited because Brazil had allegedly not, in advance of the Panel's request for information, established a prima facie case. This defense was rejected by the Appellate Body as "quite simply, bereft of any textual or logical basis".[14] Although Article 13.1 thus does not require a Member to establish a prima facie case before a panel may request information, to satisfy the Panel that Brazil is not engaging in a "fishing expedition", Brazil presents here evidence establishing a prima facie case that Canadian support constitutes prohibited export subsidies.

10. Under Article 1.1 of the SCM Agreement, a subsidy exists when a government makes a "financial contribution" that confers a "benefit," which has been defined by the Appellate Body as "terms more favourable than those available to the recipient in the market".[15] Under Article 3.1(a) of the SCM Agreement, a subsidy is prohibited if it is contingent, in law or in fact, on export. Based on these legal standards, Brazil first presents evidence establishing that support under the Canada

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[11] *Id.*

[12] WT/DS70/R, para. 9.60 ("Canada stated that because 'the modified procedures do not provide the requisite level of protection for [business confidential information], . . . Canada would not be in a position to submit [business confidential information] under the modified procedures.'") *See also* WT/DS70/AB/R, para. 195.

[13] WT/DS70/AB/R, paras. 195-196.

[14] WT/DS70/AB/R, para. 185.

[15] WT/DS70/AB/R, para. 158.

Account for one recent transaction – Air Wisconsin – constitutes a prohibited export subsidy. As noted above, this is only one example of a transaction supported by EDC, the Canada Account or IQ. Second, Brazil presents evidence regarding support *via* the EDC. Third, Brazil presents evidence with respect to IQ support.

Prima facie case with respect to Canada Account

11. Canada Account support for the Air Wisconsin transaction constitutes a prohibited export subsidy. On 10 January 2001, Canadian Minister of Industry Brian Tobin, along with Canadian Minister for International Trade Pierre Pettigrew, announced government support for the sale to Air Wisconsin of 75 Bombardier regional jets, with an option for the purchase of 75 more. While details of the Canadian government support were not provided, Rod Giles, a spokesman for EDC, noted that "[t]his transaction will be done under the [EDC's] Canada account, which is used in those instances where [the business deal] is deemed to be in the national interest."[16] A "backgrounder" regarding the Canada Account, which is administered by the EDC, was attached to the Industry Canada news release accompanying the Ministers' announcement.[17]

12. Minister Tobin characterized the support Canada was making available to Air Wisconsin as a loan or direct financing at a rate equal to that allegedly offered by Brazil for Bombardier rival Embraer's offer to Air Wisconsin.[18] Specifically, Minister Tobin stated that Canada was matching support allegedly offered by Brazil to help Embraer secure the sale.[19] According to Minister Tobin, the support allegedly offered by Brazil was itself a subsidy, granted at below-market rates.[20] Thus,

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[16] "Bombardier Snags $2.4 B order from U.S. airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001 (Exhibit Bra-2).

[17] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 (Exhibit Bra-3).

[18] "Canadian government lends $1.7 billion to Bombardier," *Canadian Machinery and Metalworking*, 11 January 2001 ("The Canadian government will lend $1.7 billion in *direct financing* to support Bombardier Inc.'s fight against heavily (and illegally) subsidized Brazilian aircraft manufacturer Embraer SA, says newly appointed Industry Minister Brian Tobin.") (emphasis added) (Exhibit Bra-4); "Ottawa backs Bombardier," *PoliticX*, 11 January 2001 ("Industry Minister Brian Tobin yesterday announced Ottawa would *lend* about $1.7 billion to a U.S. airline to buy 75 Bombardier regional jets. He said the *loan* to Air Wisconsin Airlines Corp. is necessary to match dollar-for-dollar subsidies the Brazilian government has made to its aerospace company, Empresa Brasileira de Aeronautica SA.") (emphasis added) (Exhibit Bra-5).

[19] "Canada to aid Bombardier in jet deal: Tobin vows to protect jobs in subsidy battle with Brazil", *Ottawa Citizen*, 11 January 2001 ("The subsidy, which comes from the cabinet-controlled Canada Account, will attempt to match the terms of a state-supported bid by Brazil's Embraer for the Air Wisconsin contract, Mr. Tobin said.") (Exhibit Bra-6); "Canada to match illegal Brazilian aerospace subsidies to save market share," *Ottawa Citizen*, 11 January 2001 ("'We're doing something which matches a program which has been judged illegal by the WTO [World Trade Organization],'" Industry Minister Brian Tobin said Wednesday in announcing the cabinet decision" to "match illegal Brazilian trade subsidies and loan an estimated $1.5 billion at below market rates to an American buyer of Bombardier aircraft.") (Exhibit Bra-7); "Ottawa backs Bombardier," *PoliticX*, 11 January 2001 ("Industry Minister Brian Tobin yesterday announced Ottawa would lend about $1.7 billion to a U.S. airline to buy 75 Bombardier regional jets. He said the loan to Air Wisconsin Airlines Corp. is necessary to match dollar-for-dollar subsidies the Brazilian government has made to its aerospace company, Empresa Brasileira de Aeronautica SA.") (emphasis added) (Exhibit Bra-5); "Ottawa Backs Bombardier in Brazil Trade War," *Globe and Mail*, 10 January 2001 ("Embraer, [Tobin] said, is currently able to secure preferential, below-commercial interest rates in providing financing for the sale of aircraft because of the subsidies it receives from Brazil [sic] government. Canada, he said, will match that for Bombardier.") (Exhibit Bra-8).

[20] "Canada to match illegal Brazilian aerospace subsidies to save market share," *Ottawa Citizen*, 11 January 2001 ("'We're doing something which matches a program which has been judged illegal by the WTO [World Trade Organization],'" Industry Minister Brian Tobin said . . .") (Exhibit Bra-7); "Ottawa backs Bombardier," *PoliticX*, 11 January 2001 ("Industry Minister Brian Tobin yesterday announced Ottawa would lend about $1.7 billion to a U.S. airline to buy 75 Bombardier regional jets. He said the loan to Air Wisconsin Airlines Corp. is necessary to match dollar-for-dollar subsidies the Brazilian government has made to its

anything "matching" that rate is by definition also a subsidy. In fact, Minister Tobin characterized the support offered by Canada itself in those very terms: "'What we're doing is using the borrowing strength and capacity of the government to give a better rate of interest.'"[21]

13. The $2.35 billion Air Wisconsin deal was confirmed by Bombardier on 16 April 2001, with International Trade Ministry spokesman Sebastien Theberge stating that "the deal is in essence the one announced (by Mr. Tobin)".[22]

14. Support by the Canada Account, which according to Canadian officials is the source of Canadian government support for the Air Wisconsin transaction, was found by the Panel in *Canada – Aircraft* to be a prohibited export subsidy.[23] Canadian measures adopted by Canada to implement the Panel's non-appealed findings on Canada Account were challenged by Brazil, under Article 21.5 of the DSU, as inconsistent with Article 3 of the SCM Agreement. The Article 21.5 Panel agreed, concluding that Canada had failed to implement the recommendations and rulings of the Dispute Settlement Body with respect to Canada Account.[24] This result was not appealed, and Canada has not announced further measures to bring Canada Account into compliance with its obligations under the SCM Agreement.

15. In fact, Canada has re-affirmed that support for the Canadian regional aircraft industry *via* the Canada Account continues to constitute prohibited export subsidies. In the recent Air Wisconsin transaction and current documents regarding Canada Account, Canada states that Canada Account support constitutes a financial contribution that confers a benefit, within the meaning of Article 1 of the SCM Agreement, and that it is contingent in law or in fact on export, within the meaning of Article 3.1(a) of the SCM Agreement.

16. With respect to "financial contribution", EDC's website confirms that Canada Account provides "insurance coverage, financing and guarantees"[25], each of which constitutes either a "direct

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aerospace company, Empresa Brasileira de Aeronautica SA.") (emphasis added) (Exhibit Bra-5); "Ottawa Backs Bombardier in Brazil Trade War," *Globe and Mail*, 10 January 2001 ("Embraer, [Tobin] said, is currently able to secure preferential, below-commercial interest rates in providing financing for the sale of aircraft because of the subsidies it receives from Brazil [sic] government. Canada, he said, will match that for Bombardier.") (Exhibit Bra-8).

[21] "Ottawa backs Bombardier: Loan to U.S. firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9); "Ottawa backs Bombardier," *PoliticX*, 11 January 2001 (Exhibit Bra-5).

For similar statements by Minister Tobin about the subsidised nature of Canadian government support for the Air Wisconsin transaction, *see also* "Canada to use illegal low-cost finance in aircraft subsidy dispute with Brazil," *BBC Summary of World Broadcasts*, 20 January 2001 ("Minister Tobin admits the cut-rate loan *would be illegal under international trade rules* but he says it is the only way to level the playing field and save Canadian jobs.") (emphasis added) (Exhibit Bra-10); "Air Wisconsin orders 51 jets from Bombardier," *Milwaukee Journal Sentinel*, 17 April 2001 ("The Canadian government is providing a subsidized interest rate to Air Wisconsin to make the deal. Brian Tobin, Canada's Minister of Industry, said the *subsidy* is needed to match terms offered by a Brazilian manufacturer, Embraer.") (emphasis added) (Exhibit Bra-11); "Bombardier lashes out at professor," *Globe and Mail*, 12 January 2001 ("Industry Minister Brian Tobin announced on Wednesday that Ottawa would lend the airline up to $1.7-billion at *below-market rates* to close the [Air Wisconsin] deal.") (emphasis added) (Exhibit Bra-12); "Ottawa bankrolls jet deal," *Globe and Mail*, 11 January 2001 ("Mr. Tobin said Ottawa had no choice but to retaliate with an unprecedented *direct export subsidy* to protect the jobs of 24,000 Canadian aerospace workers.") (emphasis added) (Exhibit Bra-13).

[22] "Bombardier cranks up job mill after signing $2.35-billion jet deal: Federal subsidy gives U.S. airline below-market rate," *Ottawa Citizen*, 17 April 2001 (Exhibit Bra-14). *See also* "Bombardier signs contract with Air Wisconsin for up to 150 CRJ200 regional jets," *Bombardier Press Release*, 16 April 2001 (Exhibit Bra-15).

[23] WT/DS70/R, paras. 9.231, 10.1.

[24] WT/DS70/RW (9 May 2000) (Adopted 4 August 2000), para. 6.2.

[25] EDC website, "How We Work" (Exhibit Bra-16).

transfer of funds" or a "potential direct transfer of funds or liabilities", under Article 1.1(a)(1)(i) to the SCM Agreement. Moreover, as noted above, Minister Tobin stated that Canadian support for the Air Wisconsin transaction would take the form of a loan or direct financing, which constitute "direct transfer[s] of funds"

17. With respect to "benefit", Minister Tobin acknowledges, as noted above, that Canada is matching what he characterized as subsidized support from Brazil to Air Wisconsin. Brazil recalls the Appellate Body's determination that a benefit arises when a financial contribution confers "terms more favourable than those available to the recipient in the market".[26] Any Canadian support "matching" terms more favourable than those available to Air Wisconsin in the market is, by definition, itself on similarly more favourable terms than those available to Air Wisconsin in the market. Moreover, the Minister stated that Canada was in this instance "using the borrowing strength and capacity of the government to give a better rate of interest."[27] Both of these statements, as well as others noted above, satisfy the Appellate Body's "benefit" standard.

18. Finally, with respect to export contingency, EDC's website confirms that "[t]he Canada Account is used to support export transactions . . ".[28] Similarly, the Canada Account "backgrounder" accompanying Industry Canada's announcement of its support for the Air Wisconsin deal states that Canada Account is one way for EDC to satisfy its "mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[29]

19. Thus, while the Appellate Body has held that setting forth a *prima facie* case is not a prerequisite to a request for information under DSU Article 13.1, Brazil has, with this evidence, established a *prima facie* case that Canada Account support for the Air Wisconsin transaction constitutes a prohibited export subsidy. As noted above, in its submissions to this Panel, Brazil will provide further information from publicly-available sources regarding other examples of EDC, Canada Account and IQ support for the Canadian regional aircraft industry. Direct evidence of this support, however, is solely within Canada's possession.

Prima facie case with respect to EDC

20. Canada itself, in proceedings considering the consistency of the Brazilian PROEX programME with the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), acknowledged that EDC provides support to the Canadian regional aircraft industry on terms below the commercial interest reference rates ("CIRR") established by the OECD's *Arrangement on Guidelines for Officially Supported Export Credits*. Canada noted "instances where certain of EDC's financing transactions were at a rate less than the CIRR applicable on the date the transaction closed".[30]

21. The Appellate Body stated, in its Report in *Brazil – Aircraft*, that a net interest rate "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,'" within the meaning of item (k) to

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[26] WT/DS70/AB/R, para. 158.

[27] "Ottawa backs Bombardier: Loan to U.S. firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9); "Ottawa backs Bombardier," *PolitiicX*, 11 January 2001 (Exhibit Bra-5).

[28] EDC website, "How We Work" (Exhibit Bra-16).

[29] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 ("Backgrounder" regarding "EDC – Canada Account") (Exhibit Bra-3).

[30] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (9 May 2000) (Adopted 4 August 2000), para. 6.102.

Annex I of the SCM Agreement.[31] The Appellate Body also noted in that case that the term "benefit", within the meaning of Article 1.1(b) of the SCM Agreement, is different from the term "material advantage" in item (k), and that item (k) and "material advantage" become an issue only after support has been deemed to confer a benefit and constitute a subsidy. In other words, export support that confers a material advantage will always confer a benefit, but export support that confers a benefit will not always secure a material advantage.[32]

22. Because Canada has acknowledged that EDC has lent at rates [], it has also provided, in the Appellate Body's words, "a positive indication" that EDC not only secures a material advantage, but also confers a benefit.

23. With respect to export contingency, Article 10(1) of the Export Development Act states that EDC was founded "for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[33] As such, EDC support for the Canadian regional aircraft industry is contingent in law or in fact on export, within the meaning of Article 3.1(a) of the SCM Agreement.

24. Once again, while setting forth a *prima facie* case is not a prerequisite to an Article 13.1 request for information, the evidence provided above in fact establishes that EDC support for the Canadian regional aircraft industry constitutes a prohibited export subsidy.

Prima facie case with respect to IQ

25. Along with federal aid, the Air Wisconsin transaction also benefited from IQ support, as part of a $226 million loan guarantee package recently made available to purchasers of Bombardier aircraft.[34] According to IQ spokesman Jean Cyr:

> . . . [I]n 1996 the provincial investment fund created a five-year $450-million program to provide loan guarantees to Bombardier's customers. About $300 million of that has been used, and Cyr said that on Dec. 20, Bombardier "came to us and said they were negotiating this big deal with Air Wisconsin that would require" more than the remaining $150 million.
>
> So the provincial cabinet approved another $76 million, making a total of $226 million available to airlines that buy Bombardier aircraft. That entire sum will not go entirely to the Air Wisconsin deal, Cyr said.[35]

26. As reported, IQ spokesman Cyr's comments establish that IQ has provided both a financial contribution, in the form of loan guarantees, and a benefit, by substituting the credit rating of the Government of Quebec for that of the borrower, Air Wisconsin. This principle was firmly established by Canada itself when, in *Brazil – Aircraft*, it described the beneficial effect of a loan guarantee in the following terms:

> The transaction cited by Brazil is a simple US Ex-Im Bank loan guarantee under which the Government of the United States extends its own sovereign credit risk to

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[31] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (2 August 1999) (Adopted 20 August 1999), para. 182.

[32] WT/DS46/AB/R, para. 179.

[33] Export Development Act (Exhibit Bra-17).

[34] "Ottawa backs Bombardier: Loan to U.S. firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 ("In addition to federal aid, Bombardier also secured $226 million from Investissement Quebec in loan guarantees partly for the deal with Air Wisconsin . . .") (Exhibit Bra-9).

[35] *Id.*

> cover a percentage of the amount financed. In such circumstances, the lending bank establishes financing terms in the light of the risk of the US Government, not the borrower.[36]

Thus, provision of a guarantee and substitution of a government's credit rating for that of the borrower confers a benefit.

27. With respect to export contingency, Article 25 of the Act Respecting Investissement-Québec and Garantie-Québec states that as part of its mission, IQ is directed to facilitate "export activities".[37] Similarly, paragraph 1 of Quebec Decree 572-2000 enables IQ to offer financial support to encourage companies, *inter alia*, to undertake export projects, including, under paragraph 2, the sale of goods outside of Quebec.[38] Moreover, paragraph 2 to Quebec Decree 841-2000 requires IQ to limit its financial support to, among other things, "market development" projects[39], which under paragraph 3 include the growth of export sales and the sale of goods outside of Quebec.[40] Paragraph 10 to Annex II of Decree 841-2000 provides additional information about the "market development" projects that can receive IQ support, *e.g.*, the promotion of exports in existing markets, the creation of export consortiums, and the extension of export credit margins.[41]

28. During consultations, Brazil asked Canada for details concerning IQ and its activities. Canada's representatives stated that they had no information concerning IQ, did not bring any official capable of discussing IQ to the consultations, and were therefore not prepared to discuss it. The Member whose actions are the subject of consultations has an obligation, under Article 4.2 of the DSU, to accord sympathetic consideration to the requests of other Members. In the absence of any information provided by Canada, the evidence set forth herein is sufficient to establish a *prima facie* case that IQ support constitutes a prohibited export subsidy.

Documents and information to be requested

29. To facilitate an objective assessment of the matter before it, *i.e.*, whether EDC, Canada Account and IQ provide prohibited export subsidies to support sales by the Canadian regional aircraft industry, Brazil considers that the Panel would need to request, at a minimum, documents providing the following transaction-specific information for the period 1 January 1995 to the present:

- Type of support (*e.g.*, loan, loan guarantee, equity guarantee, equity support, etc.)
- Base interest rate provided to recipient (for direct transfers of funds) or secured by recipient (for potential direct transfers of funds)
- Risk spread added onto the base interest rate
- Fee and/or premium charged

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[36] WT/DS46/RW, Annex 1-2, para. 36.

[37] Act Respecting Investissement-Québec and Garantie-Québec (Exhibit Bra-18).

[38] Décret 572-2000, 9 mai 2000, Concernant le programme du Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi, para. 1 ("1. Le prent programme vise à permettre à Investissement-Québec, dans le cadre de la réalisation de sa mission, d'apporter son soutien financier afin d'inciter les entrepreises à réaliser des projets d'investissement et d'exportation et de favoriser l'émergence de nouveaux projets . . .") (Exhibit Bra-19). *See also Id.* at para. 2 ("'exportation': toute activité ayant pour objet: - la vente de biens, la prestation de services et l'exécution de contrats à l'extérieur de Québec.").

[39] Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises, para. 2 ("L'aide financière accordée en vertu du présent programme doit avoir pour objet . . . . de développement de marchés . . .) (Exhibit Bra-20).

[40] *Id.* at para. 3 ("'Développement de marchés: . . . – la commercialisation . . . pour l'accroissement de ventes . . . à l'extérieur du Québec; - la vente de biens . . . à l'extérieur du Québec; - la formation d'un groupement d'entreprises à des fins de vente de biens . . . à l'extérieur du Québec . . . .").

[41] *Id.* at Annex II, para. 10 (10. Développement de marchés: . . . – la promotion des exportations sur un marché existant; . . . – la formation de consortium d'exportation; . . . – la marge de crédit à l'exportation . . .).

- Tenor of support
- Credit rating of recipient
- Date of transaction
- Value of transaction (in the currency of the transaction)
- Value of EDC/Canada Account/IQ support for transaction (in the currency of the transaction)
- Cash payment requirements for transaction
- Spare parts coverage of EDC/Canada Account/IQ support
- Any conditions attached to award or receipt of the support

Conclusion

30. For the foregoing reasons, Brazil requests that the Panel immediately exercise its discretion to request from Canada documents concerning EDC, Canada Account and IQ support for Canadian regional aircraft transactions from 1 January 1995 onward, including but not limited to the Air Wisconsin deal. This confidential information is not available from public sources, and Canada's failure to produce it, both in the previous *Canada – Aircraft* dispute and thusfar in these proceedings, is well-documented. A request by the Panel that Canada produce this documentary information, pursuant to DSU Article 13.1, is "necessary and appropriate" to enable the Panel to discharge its duty to make "an objective assessment of the matter before it," pursuant to Article 11 of the DSU.

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ANNEX A-3

FIRST WRITTEN SUBMISSION OF BRAZIL

Volume 1 of 4 (Narrative Submission)

(30 May 2001)

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I. INTRODUCTION

1. On 10 January 2001, Canada's Minister of Industry, Mr. Brian Tobin, announced that Canada would provide export credits that were contrary to Canada's obligations under the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement" or "Agreement") to assist the United States regional carrier Air Wisconsin in its acquisition of 75 jet aircraft, with an option for an additional 75, from the Canadian producer Bombardier.[1] The news release accompanying Minister Tobin's press conference described Canada's Export Development Corporation ("EDC") and the Canada Account as sources of the subsidy.[2] In his press conference, Minister Tobin also mentioned assistance from the Province of Quebec.[3]

2. On 22 January 2001, on the basis of Minister Tobin's statement and other information it had obtained, Brazil requested consultations with Canada. Brazil acted on the belief that export credits, within the meaning of item (k) of Annex I to the SCM Agreement, were being provided to support sales by the Canadian regional aircraft industry by Canada's EDC and the Canada Account, and that loan guarantees, within the meaning of item (j) of Annex I to the Agreement, were being provided to that industry by the Province of Quebec through its agency, Investissement Quebec ("IQ"). Brazil considered that all of these measures were subsidies, within the meaning of Article 1 of the Agreement, and that they were contingent, in law or in fact, upon export, within the meaning of Article 3 of the Agreement.

3. Consultations were held in Geneva on 21 February 2001. Canada's representatives at the consultations were unable or unwilling to specify whether assistance to Canada's regional aircraft industry would be provided by the Canada Account or EDC or both, or to provide any details beyond those given by Minister Tobin. They also stated that they were not familiar with IQ and were therefore unable to respond to any of Brazil's questions concerning IQ.

4. With Canada declining to provide any information at consultations concerning EDC, Canada Account, or IQ generally, or the Air Wisconsin transaction specifically, Brazil concluded that Canada had not provided the "sympathetic consideration" mandated by Article 4.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("Dispute Settlement Understanding" or "DSU"), and that the dispute could not be settled through consultations.

5. On 1 March 2001, Brazil requested the establishment of a panel pursuant to Article XXIII of the GATT 1994, Article 6 of the DSU, and Article 4.4 of the SCM Agreement. Brazil requested that the panel consider and find that:

1. Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

2. Canada has not implemented the report of the Article 21.5 Panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

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[1] Transcript of Press Conference of Industry Minister Brian Tobin, 10 January 2001, para. 7 ("Tobin Press Conference") (Exhibit Bra-21). The transcript was made from a recording of the press conference made by the Canadian Parliamentary Press Gallery, a group of journalists accredited to cover Canadian Government and Parliament and granted space in the Parliament buildings.

[2] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 (Exhibit Bra-3).

[3] Tobin Press Conference, para. 7 (Exhibit Bra-21).

3. Canada, in defiance of the rulings and recommendations of the Dispute Settlement Body, continues to grant or offers to grant export credits to the regional aircraft industry through the Canada Account, that are prohibited subsidies within the meaning of Articles 1 and 3 of the Agreement.

4. Canada's grant or offer to grant Canada Account export credits to Air Wisconsin is a prohibited export subsidy within the meaning of Articles 1 and 3 of the Agreement.

5. Export credits, including financing, loan guarantees, or interest rate support by or through the EDC are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

6. Canada's grant or offer to grant export credits by or through EDC to Air Wisconsin is a prohibited export subsidy within the meaning of Articles 1 and 3 of the Agreement.

7. Export credits and guarantees provided by *Investissement Quebec*, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees" are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.[4]

6. Brazil further requested that the Panel recommend that the Dispute Settlement Body ("DSB") direct Canada to withdraw these prohibited subsidies without delay.[5] On 12 March 2001, the DSB established the Panel with the standard terms of reference. Because the parties were unable to agree on the composition of the Panel, on 7 May 2001 Brazil requested that the Director-General compose the Panel. On 11 May 2001, the Director-General announced the composition of the Panel.

7. In this Submission, Brazil will first discuss its prior challenge to these same programmes, beginning with the Canada Account, then EDC and concluding with IQ. Because Canada Account is operated by EDC, however, the complex facts in this dispute are best understood if the discussion on the merits treats EDC first and then Canada Account. Accordingly, after the discussion of the prior case, which begins with Canada Account, Brazil will begin its presentation of facts and argument in this case with EDC. In the course of the discussion of EDC and Canada Account, the term "Corporate Account" is sometimes used. This refers to operations that are both administered by EDC and are the financial responsibility of EDC.[6] Canada Account, as explained below,[7] is administered by EDC but is the financial responsibility of the Government of Canada.

II. BRAZIL'S PRIOR CHALLENGE TO THESE PROGRAMMES

8. This is the second time a Panel has had occasion to examine the EDC, Canada Account, and IQ programmes, through which Canada subsidizes exports of regional aircraft manufactured by Bombardier.[8] Brazil has taken the unusual step of challenging these three measures for a second time because: (1) with regard to one of the measures – export assistance through the Canada Account – Canada continues to utilize a programme previously found to be a violation of its commitments under

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[4] *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Request for the Establishment of a Panel by Brazil, WT/DS222/2 (1 March 2001).

[5] *Id.*

[6] Although this has been Canada's position in the past, Brazil notes that EDC's Annual Report states that "EDC is for all purposes an agent of Her Majesty in right of Canada. All obligations under debt instruments issued by the Corporation are obligations of Canada." EXPORT DEVELOPMENT CORPORATION ANNUAL REPORT 2000, pg. 47 ("EDC 2000 Annual Report") (Exhibit Bra-22).

[7] *See infra* para. 74.

[8] The initial occasion was *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (14 April 1999) (Adopted 20 August 1999), and WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999).

the SCM Agreement; (2) with regard to another of the measures – export assistance through EDC – additional information and further developments have led Brazil to act on the suggestion of the Appellate Body in the previous proceeding that it bring the matter before a Panel again; and (3) with regard to the third measure – export assistance through IQ – Brazil has obtained additional information supporting its claims.

A. CANADA ACCOUNT

9. On 29 August 1999, the DSB adopted the Panel Report, as upheld by the Appellate Body, in "*Canada – Aircraft*". That Report found that Canada Account export credits were subsidies contingent in law upon export performance, and were therefore prohibited by Article 3.1(a) of the SCM Agreement. The DSB recommended that Canada withdraw these subsidies within 90 days.

10. In a Status Report to the DSB on 18 November 1999, Canada stated:

> With respect to Canada Account debt financing for the export of Canadian regional aircraft, which was found to be inconsistent with Canada's obligations under the SCM Agreement, *Canada wishes to inform the DSB that there will be no deliveries of regional aircraft after 18 November 1999 benefiting from such Canada Account financing*. In addition, the Minister for International Trade has approved a policy guideline which requires that all future Canada Account transactions for all sectors, not only those involving the regional aircraft sector, comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits. By this policy, the Minister undertakes not to authorize any transaction under the Canada Account unless it complies with the Arrangement. No Canada Account transaction may proceed without Ministerial authorization.[9]

11. Brazil was of the view that this action was insufficient to implement the ruling and recommendation of the DSB with regard to the Canada Account, and, accordingly, sought review under Article 21.5 of the DSU. The Panel established to examine the matter agreed with Brazil, concluding that "Canada has failed to implement the 20 August 1999 recommendation of the DSB that Canada withdraw the Canada Account assistance to the Canadian regional aircraft industry within 90 days."[10]

12. Canada did not appeal that conclusion. Since that date, however, Canada has done nothing to implement the recommendation of the DSB, and remains in default of its obligations under the SCM Agreement.

13. Canada's pledge to the DSB that "there will be no deliveries of regional aircraft after 18 November 1999 benefiting from such Canada Account financing" was violated on 10 January 2001 when Minister Tobin announced that Canada intended to support the Bombardier – Air Wisconsin sale with illegal subsidies. These subsidies were on terms that, Minister Tobin admitted, were inconsistent with the SCM Agreement.[11]

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[9] *Canada – Measures Affecting the Export of Civilian Aircraft – Status Report by Canada*, WT/DS70/8 (26 November 1999) (emphasis added).

[10] *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (9 May 2000) (Adopted 4 August 2000), para. 6.2.

[11] *See, e.g.*, Tobin Press Conference, para. 66 (Exhibit Bra-21). *See also* Brazil's letter to the Panel dated 21 May 2001, paras. 12-13.

B. EXPORT DEVELOPMENT CORPORATION

14. Brazil also challenged EDC in *Canada – Aircraft*. In that proceeding, Brazil was severely hampered by the fact that Canada had not notified the relevant details of its EDC subsidy programme to the WTO, as required by Article 25 of the SCM Agreement. The Panel, accordingly, requested specific information from Canada, information that Canada refused to provide.[12] While the Panel stated that it "regret[ted] deeply Canada's refusal to provide the requested information,"[13] the Panel concluded that without the information requested from Canada, Brazil had not presented a *prima facie* case, and therefore found in favour of Canada.[14]

15. Brazil appealed, arguing that the Panel erred in law in not drawing inferences adverse to Canada from its refusal to provide information requested by the Panel itself. In an opinion that made clear the responsibility of parties to provide information to Panels, the Appellate Body also made clear the specific authority of Panels to draw appropriate inferences from the failure of parties to provide requested information.[15] The Appellate Body went on to state that, had it "been deciding the issue that confronted the Panel, we might well have concluded that the facts of record did warrant that the information Canada withheld" called for an inference adverse to Canada.[16] However, the Appellate Body concluded that, while it might have decided the question differently, the Panel had not erred in law or abused its discretion.[17]

16. In declining Brazil's appeal, the Appellate Body made a highly unusual – if not unprecedented – suggestion that Brazil bring the same case before a Panel again. "By this finding," the Appellate Body said, "we do not intend to suggest that Brazil is precluded from pursuing another dispute settlement complaint against Canada, under the provisions of the *SCM Agreement* and the DSU, concerning the consistency of certain of the EDC's financing measures with the provisions of the *SCM Agreement*."[18] The Appellate Body even suggested an alternative proceeding in the Committee on Subsidies and Countervailing Measures that Brazil might consider.[19]

17. Brazil did not act upon the Appellate Body's suggestion when it was made because the parties had been actively involved in negotiations since August 1999, in an attempt to resolve their differences. These negotiations, however, have not been successful, and, in light of subsequent actions taken by Canada, Brazil has decided to follow the Appellate Body's suggestion, and pursue "another dispute settlement complaint against Canada, under the provisions of the *SCM Agreement* and the DSU, concerning the consistency of the EDC's financing measures with the provisions of the *SCM Agreement*."

18. In this proceeding, Brazil will place before this Panel the evidence that, when presented to the prior Panel, prompted that Panel's request to Canada for specific information. Brazil also will present evidence it has subsequently been able to obtain, despite the continuing lack of transparency that characterizes EDC's operations. Brazil believes that this Panel, like the prior Panel, should request that Canada produce any information necessary for the Panel to make an objective assessment of all of the relevant facts. By letter of 21 May 2001, Brazil has requested the Panel to make an appropriate request of Canada for information relevant to this dispute that is in Canada's sole possession. Should Canada continue to decline to provide that information, Brazil requests that this Panel, in light of the

[12] WT/DS70/R, para. 9.176.
[13] WT/DS70/R, para. 9.178.
[14] WT/DS70/R, para. 9.182.
[15] WT/DS70/AB/R, paras. 181-206.
[16] WT/DS70/AB/R, para. 205 (footnote omitted).
[17] *Id.*
[18] WT/DS70/AB/R, para. 206.
[19] *Id.*

extended discussion by the Appellate Body in paragraphs 181 through 206 of its Report in *Canada – Aircraft*, draw the appropriate adverse inferences.

C. INVESTISSEMENT QUÉBEC

19. With regard to IQ, the earlier Panel also concluded that Brazil had not adduced sufficient evidence to establish a *prima facie* case.[20] In that proceeding as well, Brazil was hampered by the lack of transparency in Canada's programmes. Brazil pointed to the November 1998 Trade Policy Review of Canada as evidence of subsidies provided by IQ, noting that it did so by "provid[ing] export guarantees for projects considered too risky for private financial institutions."[21] However, the Panel concluded that the Trade Policy Review is not "'intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures'" and therefore declined to consider that evidence.[22]

20. As it did with regard to other programmes, in *Canada – Aircraft* Canada refused to provide information requested by the Panel regarding IQ.[23] In this proceeding, Brazil continues to hampered by the lack of transparency in the programme, and IQ therefore is included in Brazil's 21 May request to the Panel. Nevertheless, Brazil has been able to obtain some additional information concerning IQ, and provides that information to the Panel in this submission.

III. EXPORT DEVELOPMENT CORPORATION ("EDC")

A. EDC WAS ESTABLISHED TO PROVIDE FINANCIAL SERVICES TO CANADIAN EXPORTERS ON MORE FAVOURABLE TERMS THAN THEY COULD OBTAIN IN THE MARKET

21. EDC was established in 1969 "for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[24] Its status as a Crown corporation allows it three important privileges:

1. It does not have to pay income tax;
2. It does not have to pay dividends;
3. It can borrow on the credit of the Government of Canada.[25]

22. EDC, in its own words, "is volume-driven, as opposed to other financial institutions that are profit-driven."[26] "If EDC were to be privatized," the Corporation points out, "its corporate focus would shift to maximizing profit, rather than maximizing exports. Thus, as a private entity, in order to return the maximum profit to its shareholders, EDC would no longer be able to serve the market segments that are already not well served by commercial lenders and insurers. ... EDC, as a Crown corporation, services Canadians in a manner that other institutions do not."[27]

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[20] WT/DS70/R, para. 9.275.
[21] WT/DS70/R, para. 9.274.
[22] *Id.*
[23] WT/DS70/R, para. 9.272.
[24] Export Development Act, Section 10(1) (Exhibit Bra-17); EDC 2000 Annual Report, pg. 47 (Exhibit Bra-22).
[25] EXPORT DEVELOPMENT CORPORATION 1999-2000 REFERENCE GUIDE, pg. 9 ("EDC Reference Guide") (Exhibit Bra-23).
[26] *Id.*, pg. 10.
[27] *Id.*, pg. 26.

23. EDC repeatedly makes clear that, in maximizing exports rather than profits, its object and purpose is to provide financial services to Canadian exporters on terms more favourable than those that exporters can obtain in the market:

- "Canadian firms' ability to access capital for international sales and investments has been limited. Many Canadian companies simply lack the financial strength to mobilize debt and investment financing to the same degree as their more highly capitalized rivals."[28]

- "International trade is risky, and it requires financial capacity that is often lacking because of those risks. EDC was created to help companies manage those risks and to increase the international finance capacity available to Canadian companies. By enhancing Canada's export capacity, EDC helps companies create and maintain employment and generate profits."[29]

- "EDC has demonstrated its appetite for international risk repeatedly in the past, including during the Asian crisis of 1997, which prompted many private financial intermediaries to withdraw from the marketplace. Such episodes underscore the need for a financial institution devoted exclusively to the financial needs of Canadian exporters."[30]

24. EDC, as it admits, raises its capital from the taxpayers of Canada and by borrowing on the sovereign credit of the Government of Canada. "All obligations under debt instruments issued by the Corporation are obligations of Canada."[31] It thus is able to raise funds at rates no market-based institution can match. Then, again by its own admission, unlike a market-based institution, it pays no income tax on any profits it may earn, and its shareholder expects no dividends. These advantages permit EDC to provide to Canadian exporters, including exporters of regional aircraft, financial services that those exporters or their customers would not be able to obtain in the market on equally favourable terms.

25. EDC explicitly acknowledges this role: "EDC complements the banks and other financial intermediaries, but cannot substitute for them."[32] Its "goal is to help absorb the risk on behalf of Canadian exporters, beyond what is possible by other financial intermediaries".[33] EDC, in its own words, attempts to satisfy "the seemingly endless appetite of Canadian exporters for financial support . . . "[34]

26. The former President of EDC, Mr. Paul Labbé, in testimony before the Canadian Parliament, made clear the gap between EDC and a market-based institution. EDC strives to "mak[e] at least the rate of inflation," he said, recognizing that this is well below the return "that would be required to survive in the private sector."[35] The current President of EDC, Mr. Ian Gillespie, has stated, "The goal for Canada is to make sure that we have a competitive advantage . . . not just a level playing field."[36]

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[28] EDC 2000 Annual Report, pg. 3 (Exhibit Bra-22).

[29] *Id.*, pg. 14.

[30] *Id.*, pg. 17.

[31] *Id.*, pg. 47 (note 1).

[32] EXPORT DEVELOPMENT CORPORATION, 1995 *Chairman and President's Message*, pg. 4 ("EDC Message") (Exhibit Bra-24).

[33] *Id.*, pg. 2.

[34] *Id.*, pg. 4.

[35] Testimony of EDC Officials, Senate of Canada, 35th Parliament, 1st Sess., Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, Issue No. 48, 28 November 1995, pg. 48:22 (Exhibit Bra-25).

[36] Testimony of EDC President Mr. Ian Gillespie before the Standing Committee on Foreign Affairs and International Trade, 6 November 1997, pg. 15 (Exhibit Bra-26).

27. Canada achieves that "competitive advantage" through the operations of a so-called "Market Window." This is the term used to describe the "market" or "unofficial" operations of EDC, as opposed to its "official" operations. It is not a term used in any WTO agreement, and therefore, Brazil believes, it is a term with which few WTO Members are familiar. However, the export credit operations of Canada's market window have been criticized by others besides Brazil. Because of the importance of Canada's market window operations to EDC's operations, Brazil will describe market windows and how they operate in the next section of this Submission. In the subsequent sections, Brazil will demonstrate that EDC provides subsidies contingent upon export to the regional aircraft industry. The fact that these subsidies may be provided through market window operations does not change the fact that they are subsidies.

B. CANADA USES THE "MARKET WINDOW" TO PROVIDE FINANCIAL SERVICES TO CANADIAN EXPORTERS ON MORE FAVOURABLE TERMS THAN THEY COULD OBTAIN IN THE MARKET

28. Government-supplied export credits normally fit the SCM Agreement's definition of a prohibited subsidy. They consist of financial contributions that are intended to confer a benefit, within the meaning of Article 1, and they are contingent upon export within the meaning of Article 3. However, the SCM Agreement provides an exception to this requirement by way of item (k) of Annex I, the "Illustrative List of Export Subsidies." The second paragraph of item (k) specifies that export credit practices that conform to the "interest rates provisions" of the *Arrangement on Guidelines for Officially Supported Export Credits ("OECD Arrangement" or "Arrangement")* are not considered to be prohibited export subsidies.[37] The *Arrangement* applies to "all official support for exports of goods and/or services, or to financial leases, which have repayment terms ... of two years or more."[38]

29. The term "official support" is not defined in the *Arrangement*, because the participants cannot agree on a definition.[39] Their disagreement centers on another term, "market window."[40] The export credit practices of Canada are central to the disagreement in the OECD over the definition "official support" and the legitimacy of "market window" operations by export credit agencies that provide official support." The *Brazil – Aircraft* Article 21.5 Panel was "struck" by the fact that Canada described an EDC market window transaction below the official OECD rate as, nevertheless, "commercial."[41]

30. While Canada is a participant in the *OECD Arrangement* and, through EDC, provides "official support" to exports, it also claims to provide "unofficial support" through the "market window." Canada has described market window operations in these terms:

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[37] Item (k) second paragraph refers 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." The *OECD Arrangement* is the only international undertaking that fits this description. WT/DS70/RW, para. 5.78. In addition to the second paragraph of item (k), Brazil is of the view that certain export credits receive a safe haven under the first paragraph as well, based on an *a contrario* interpretation of that paragraph. In addition, by virtue of Article 27, Article 3's prohibition does not apply to developing countries, in certain specified circumstances, until 1 January 2003.

[38] *OECD Arrangement* (1998), Art. 2.

[39] *OECD Arrangement* (1998), Art. 88 ("It has not proved possible to reach total agreement on the definition of official support in the light of differences between long-established national export credit systems.").

[40] *OECD Arrangement* (1998), Art. 86 ("The Participants undertake to investigate further both the issue of transparency and the definition of market window operations in order to prevent distortion of competition.").

[41] *Brazil – Export Financing Program for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (9 May 2000) (Adopted 4 August 2000), para. 6.99. The OECD rate is termed the "Commercial Interest Reference Rate" or "CIRR." *See OECD Arrangement* (1998), Art. 15.

> The term "market window" is used to describe the provision of financing on terms that are consistent with those that are available in the market place to a particular borrower in a particular transaction. When an export credit agency provides "market window" financing, it is providing financing on terms and conditions consistent with those available from commercial banks and lenders. In that sense, the borrower obtains a net interest rate that is consistent with the market. Since the borrower could go out on the market and obtain a competitive rate in respect of the transaction from a commercial bank or lender, no benefit is conferred within the meaning of Article 1 of the SCM Agreement and, therefore, no subsidy exists.[42]

Under this logic, Canada does not consider that its market window transactions require recourse to the safe haven included in the second paragraph of item (k) to the Illustrative List.

31. "Market window transactions," according to Canada, "are different from 'official support' transactions....[T]he disciplines of the *OECD Arrangement* are simply not applicable to 'market window' transactions."[43] "'[M]arket window' transactions," Canada emphasizes, "are entered into on terms and conditions that are consistent with those that are otherwise available to a borrower in the marketplace."[44] Thus, "Canada stated at the meeting with the Panel on 4 February 2000 that, if the Export Development Corporation provides financing at rates equal to or higher than its borrowing costs, but below the CIRR, that practice may still not constitute a subsidy because no benefit is conferred."[45]

32. Canada's position is evident in its description of the *OECD Arrangement*:

> The OECD Consensus guidelines ... set out the most generous terms and conditions permitted on *non-market* business and hence prevent a destructive and costly export credit race among governments seeking to promote their national exports. In addition, the OECD provides a transparency mechanism by which the OECD Consensus members can exchange information about their policies and practices. Canada is an OECD Consensus member and subject to OECD Consensus guidelines for all its *official support* business.[46]

33. Brazil is not a member of the OECD, and therefore is unable to comment on of the "transparency mechanism" in the *Arrangement* to which Canada refers. Brazil can state, however, that while that mechanism may provide transparency for the OECD members, there is *nothing* that provides transparency concerning Canada's market window operations to the majority of WTO Members that are not members of the OECD. Canada attempts to justify this lack of transparency by likening EDC, in its market window mode, to a normal commercial bank. For example, in responding to a series of recommendations concerning EDC operations that were part of a recent review of EDC, Canada's Department of Foreign Affairs and International Trade stated:

> ...[I]n terms of the extent of disclosure, a distinction could be drawn between Canada Account and Corporate Account. The former tends to be higher-risk sovereign business which is taken as a direct liability of the Government, while the latter

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[42] WT/DS46/RW, Annex 1-4, Responses by Canada to Questions of the Panel, Canada's Responses to the Panel's Questions Posed on 3 February 2000, Response to Question 2 (Exhibit Bra-27).

[43] *Id.*, Response to Question 4.

[44] *Id.*, Response to Question 6.

[45] WT/DS46/RW, Annex 1-4, Responses by Canada to Questions of the Panel, Response by Canada to Panel's Further Question Posed on 7 February 2000 (Exhibit Bra-27).

[46] EDC Reference Guide, pg. 7 (emphasis added) (Exhibit Bra-23). The term "*OECD Consensus*" is sometimes used rather than "*OECD Arrangement.*" The term "Corporate Account," of course, includes both "official" and "unofficial" support provided by EDC, in contrast to Canada Account support.

> includes a much higher percentage of "market window" commercial transactions, where the need to protect confidentiality would be greater, and where the risk of loss remains with the Corporation itself.[47]

34. Similarly, in response to the question, "Why doesn't EDC publicly disclose its transactions?", EDC states:

> EDC operates in much the same manner as a bank or insurance company. It receives a great deal of confidential information from its customers and potential customers and does not disclose this information without their permission.[48]

35. But EDC is not just another bank. It is a government-owned entity whose actions are subject to the SCM Agreement. It possesses advantages no private financial institution possesses: (1) it borrows at the sovereign rate of the Government of Canada; (2) it pays no income taxes; and (3) its shareholder expects no dividends.[49] This permits EDC, whenever it chooses to do so, to offer terms and conditions more favourable than those that can be offered by a market-based financial institution, to obtain "a competitive advantage for Canadian exporters, not just a level playing field."[50] The difference between EDC and a bank is further demonstrated by its customer restriction. A bank would finance any transaction, provided the bank believed it would be profitable. Neither the nationality of the manufacturer nor that of the buyer would matter, nor would the national origin of parts and components in any product financed. EDC, however, supports only Canada's export trade.[51]

36. Former United States Treasury Secretary Lawrence H. Summers has noted that "Market Window institutions *purport* to operate under private sector discipline". "However," he added:

> we believe that Market Window institutions either directly, or potentially, contravene [OECD] Arrangement rules because they are controlled and implicitly subsidized by the state. Thus, *Market Window institutions operate with an unfair competitive advantage* because they benefit from special government concessions including guarantees by the state that enable them to raise funds at a lower cost than their private sector competitors, and because they are exempted from certain taxes and dividend payments. At the same time they act like official export credit agencies in restricting financing to national exporters.[52]

37. Secretary Summers's analysis is confirmed by the Head of the OECD Trade Directorate and one of its specialists in export credits and financing. They define market windows as "institutions related to governments which are able to raise finance and lend at very low rates of interest but which may not currently follow all the provisions of the Arrangement."[53]

38. While market windows may remain a matter of debate within the OECD, they are not a matter of debate within the WTO. A government export credit agency ("ECA") is a "government or any public body within the territory of a Member" within the meaning of Article 1. Whether a credit

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[47] GOVERNMENT RESPONSE TO THE STANDING COMMITTEE ON FOREIGN AFFAIRS AND INTERNATIONAL TRADE (SCFAIT) REVIEWING THE EXPORT DEVELOPMENT ACT, pg. 12 (Exhibit Bra-28).

[48] EDC Reference Guide, pg. 26 (Exhibit Bra-23).

[49] *Id.*, pg. 9 (Exhibit Bra-23).

[50] Testimony of EDC President Mr. Ian Gillespie before the Standing Committee on Foreign Affairs and International Trade, 6 November 1997, pg. 15 (Exhibit Bra-26).

[51] EDC 2000 Annual Report, pgs. 3, 14, 47 (Exhibit Bra-22).

[52] Lawrence H. Summers, "The Importance of Continuing to Fight Against International Trade Finance Subsidies," Remarks at the 65th Anniversary of the Export Import Bank, 16 May 2000, pg. 3 (emphasis added) (Exhibit Bra-29).

[53] Steve Cutts & Janet West, "The arrangement on export credits," *OECD Observer*, 1 April 1998, pgs. 12, 14 (Exhibit Bra-30).

provided by an ECA is "official support" within the meaning of the *OECD Arrangement* is irrelevant for the purposes of the WTO. Since an ECA is a government entity, any credit it provides must meet WTO requirements. An ECA makes a financial contribution within the meaning of Article 1 whenever it makes loans or guarantees or provides other financial services. The only questions remaining are "benefit" and "contingent upon export," points that are discussed in Sections III.D and III.E, *infra*. If a market window operation meets these criteria, then it constitutes a prohibited subsidy unless it qualifies for the safe harbor of item (k).

39. The position Canada has taken throughout these disputes, that market window operations are private and need not be transparent, is particularly subversive of the WTO system because it leaves to Canada and Canada alone the right to decide, in secrecy, whether and how it will meet its international obligations. Canada's position is that when a potential transaction is presented to EDC, it is for EDC to decide whether the Corporate Account support it provides will be "official" or "unofficial." If the former, then, presumably, the transaction is transparent. But if EDC decides to use the market window, the transaction becomes "private" and transparency is not, in Canada's view, required. To be sure, Canada concedes that both kinds of support, official and unofficial, are subject to WTO rules. But as to whether those rules are being observed in market window transactions, Canada's position boils down to this: "Trust us." If the rule Canada sets for itself were adopted by the entire WTO Membership, the disciplines of the SCM Agreement with regard to export credits would be non-existent.

C. EDC PROVIDES A FINANCIAL CONTRIBUTION TO REGIONAL AIRCRAFT

40. EDC offers "a wide range of financial services" to Canadian companies.[54] These financial services include credit insurance, financing services, bonding services, political risk insurance and equity.[55] They constitute financial contributions within the meaning of Article 1.1(a)(1) of the SCM Agreement.

41. Canada's regional aircraft industry, headed by Bombardier, is a major user of these services. The Air Transportation category accounted for fully 26 per cent of all EDC performing commercial loans in 1999.[56] EDC's Chief Economist has noted that, "The transportation sector is a very big contributor to Canada's robust export performance. Excluding cars, exports in the ground transportation and aerospace sectors were nearly $12 billion last year, and EDC's participation in insurance and financing amounted to something like $4 billion, about a third of the total."[57]

42. EDC's extensive support of Bombardier can also be demonstrated by statistical analysis. A regression analysis of the volume of EDC's commercial loans and Bombardier's aerospace and transport revenues for the period 1995 through 2000 demonstrates the close correlation between Bombardier's sales and EDC's loans.[58] The coefficient of determination (R^2) between Bombardier's aerospace and transport revenues on the one hand, and EDC's commercial loans on the other, is high: 0.9895. This means that there is an extremely strong association between the annual level of EDC's commercial loans and the annual level of Bombardier's aerospace and transport revenues. Minister Tobin confirms this analysis less technically: "I can't give you the total number of accounts today that Bombardier has with EDC, but it has a significant number."[59] One of those accounts, of course, would be for the Air Wisconsin transaction announced that same day by Minister Tobin.

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[54] EDC 2000-2004 CORPORATE PLAN SUMMARY, pg. 4 (Exhibit Bra-31).

[55] *Id.*, pgs. 4-5.

[56] EDC 2000 Annual Report, pg. 28 (Exhibit Bra-22).

[57] Stephen S. Poloz, "The Global Transportation Outlook: Moderate Turbulence Ahead," 11 September 2000, pg. 1 (Exhibit Bra-32).

[58] Regression Analysis (Exhibit Bra-33).

[59] Tobin Press Conference, para. 27.

43. Public information confirms that, in addition to the Air Wisconsin sale, the regional aircraft industry utilizes financial services from EDC in acquiring Bombardier aircraft:

- *Air Finance Journal* reports EDC's participation in financing a $112 million sale of eight Bombardier CRJ jets to the Australian regional airline, Kendell.[60] Bombardier announced the transaction in an October 1998 press release.[61]

- The US Regional carrier, ASA, in a 1997 10-Q Form, noted that in April 1997 it reached an agreement for the sale of 30 CRJs (with options for an additional 60 aircraft), valued at approximately US $600 million, to ASA Holdings, Inc., and its subsidiary, Atlantic Southeast Airlines.[62] The transaction included a commitment from EDC to finance up to 85 per cent of the purchase price or the lease for all 30 CRJs, an option exercised by ASA for those aircraft delivered to date.[63] EDC's commitment was used to finance 16.5-year leases of the CRJs.[64]

- In a Form 10-K filed with the US Securities and Exchange Commission for the fiscal year 1998, ASA reported a transaction with Bombardier and stated, "ASA obtained a commitment from the Export Development Corporation (EDC) of Canada to provide financing to ASA for up to approximately 85 per cent of the purchase price of the 45 CRJ-200 aircraft."[65]

- The US regional carrier Comair, in a Form 10-K filed with the US Securities and Exchange Commission for the fiscal year ended March 31, 1998, reported that it "took delivery of eleven new generation, 50-passenger Canadair Jet aircraft throughout fiscal 1998 bringing the total Canadair Jet fleet to 59. ... Comair expects to finance the aircraft described above through a combination of working capital and lease, equity and debt financing, utilizing manufacturer's assistance and *government guarantees* to the extent available."[66]

- Comair repeated this statement in a subsequent Form 10-Q filed with the US Securities and Exchange Commission.[67]

- In a 10-K filing with the US Securities and Exchange Commission for the fiscal year 1997, Midway Airlines Corp. reported the acquisition of 10 CRJ aircraft, and options for 20 more, for a term of 16.5 years at a rate of 6.9 per cent.[68]

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[60] Dominic Jones, "Ready, Steady . . . ," *Air Finance Journal*, January 2000, pg. 48 (Exhibit Bra-34).

[61] "Bombardier signs major Canadair Jet order with Australia's Kendell Airlines," *Bombardier Press Release*, 21 October 1998 (Exhibit Bra-35).

[62] ASA Holdings, Inc., Form 10-Q, filed with the US Securities and Exchange Commission for the quarterly period ended 31 March 1997, website pagination pg. 12 (Exhibit Bra-36).

[63] ASA Holdings, Inc., Annual Report 1997, "Liquidity and Capital Resources," Lexis Disclosure Report, pgs. 15-16 (Exhibit Bra-37).

[64] *Id.*

[65] ASA Holdings, Inc., U.S. Securities and Exchange Commission Form 10-K for the fiscal year ended 31 December 1998, website pagination pg. 48 (Exhibit Bra-38).

[66] Comair Holdings, Inc., U.S. Securities and Exchange Commission Form 10-K for the fiscal year ended 31 March 1998, website pagination pg. 33 (emphasis added) (Exhibit Bra-39).

[67] Comair Holdings, Inc., U.S. Securities and Exchange Commission Form 10-Q for the quarterly period ended 30 June 1998, website pagination pg. 14 (Exhibit Bra-40).

[68] Midway Airlines Corp., U.S. Securities and Exchange Commission Form 10-K for the fiscal year ended 31 December 1997, website pagination pg. 30 (Exhibit Bra-41). The filing also states that the 6.9 percent rate became an "effective" 7.2 percent rate. It does not state that EDC was involved in the transaction; however, Embraer has informed Brazil that its trade sources state that EDC was involved in the financing. Any information with regard to EDC's involvement is, of course, in Canada's sole possession, as noted in Brazil's 21 May letter to the Panel requesting that the Panel ask Canada to provide relevant information.

44. Financing of the kind provided by EDC, such as that provided to Kendell and ASA, constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. It is a direct transfer of funds in the form of a loan. Moreover, financing by EDC of the kind announced by Minister Tobin for Air Wisconsin constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement, as a direct or potential direct transfer of funds.

45. Guarantees of the kind provided by EDC, such as those provided to Comair, also constitute a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. These are potential direct transfers of funds.

46. The provision by EDC of financial services in the form of export credits, including loans and guarantees, constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement. These are services other than general infrastructure.

D. CONFERS A BENEFIT TO REGIONAL AIRCRAFT

1. Terms More Favourable than Provided for In the *OECD Arrangement* are Positive Evidence of a Benefit

47. The Panel in *Canada – Aircraft* determined that a benefit is conferred when a "financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution."[69] The Appellate Body upheld this determination with specific reference to loans, loan guarantees, and the provision of services by a government, holding that a benefit arises under each of these "if the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[70] The available evidence demonstrates that the recipients of EDC's loans, loan guarantees and financial services obtain those financial contributions on terms more favourable than those available to them in the market.

48. As the previous *Canada – Aircraft* dispute made more than clear, the market for aircraft finance is characterized by an overall lack of transparency. Canada chooses not to disclose any of the details of the transactions in which it is involved. Participants in the market, such as airlines, appear to disclose only when legally required, as is sometimes the case with securities filings in the United States.

49. In an effort to discipline the extensive and secret government involvement in financing, including aircraft, the participants in the OECD created the *Arrangement* in 1978. The second paragraph of item (k) of Annex I to the SCM Agreement, the "Illustrative List of Export Subsidies," as noted above, specifies that export credits provided by any WTO Member – whether or not a member of the OECD – that are applied in conformity with the interest rates provisions of the *Arrangement*, are not prohibited.[71]

50. The *Arrangement* places limitations on the terms and conditions of export credits that benefit from official government support. It "sets out the *most generous* repayment terms and conditions that may be supported."[72] It establishes a level below which government export credit agencies should not go in providing credits in any form to support exports.

51. In *Brazil – Aircraft*, the Appellate Body concluded that the *Arrangement* is an appropriate benchmark against which to assess whether payments by governments are used to secure a material

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[69] WT/DS70/R, para 9.112.
[70] WT/DS70/AB/R, para. 158.
[71] *See supra* para. 28.
[72] *OECD Arrangement* (1998), Introduction (emphasis added) (Exhibit Bra-42).

advantage in the field of export credit terms within the meaning of item (k) first paragraph.[73] The Appellate Body also noted that "benefit" and "material advantage" are different, and that item (k) and material advantage become an issue only when a subsidy – including a benefit – already is present. In other words, export support that confers a material advantage will always confer a benefit, but export support that confers a benefit will not always secure a material advantage.[74]

52. This analysis is consistent with that of the Article 21.5 Panel in *Brazil – Aircraft*, where the issue was whether an interest rate benchmark below the relevant Commercial Interest Reference Rate ("CIRR") of the *Arrangement* conferred a material advantage within the meaning of item (k) first paragraph. The Panel observed that the Appellate Body "identified the CIRR as a relevant benchmark under the material advantage clause because it represents the '*minimum* commercial interest rate' faced by a potential borrower in respect of a particular currency."[75] The Panel went on to observe that, "the CIRR is intended in principle to approximate the interest rate that first class borrowers would pay 'commercially,' *i.e.*, in private transactions not benefiting from official support."[76]

53. The fact that a net interest rate to a borrower is below the relevant CIRR is "positive evidence" that it secures a material advantage.[77] *A fortiori*, since material advantage has a lower threshold than benefit, a rate below the relevant CIRR is also positive evidence that a benefit is thereby conferred. While the Appellate Body in *Brazil – Aircraft* specifically was addressing interest rates and the first paragraph of item (k), its reasoning applies equally to the other terms and conditions of the *Arrangement*. The legal principle established in that case is that the *Arrangement* presumptively establishes the most favourable terms available in the market, and the granting of more favourable terms is positive evidence not only of material advantage, but also of a benefit.

54. In addition to the CIRR, the provision of the *Arrangement* most relevant to this proceeding is Article 21 of its *Sector Understanding on Export Credits for Civil Aircraft* which provides for a maximum repayment term for regional aircraft of 10 years.[78] Just as an interest rate below the CIRR is positive evidence of a material advantage, and, *a fortiori*, a benefit, so too a repayment term of more than 10 years for regional aircraft is positive evidence of a benefit. As Canada itself has said elsewhere:

> The second paragraph [of item (k)] provides an exception to the application of Article 3 for export credit practices that apply the 'interest rates provisions' of the *OECD Arrangement*. Those provisions include provisions relating to CIRR and to the *repayment term* of the support being extended. Thus, if a Member applies the "interest rates provisions" of the Arrangement, an export credit practice that is in conformity with these provisions will not be considered an export subsidy prohibited under Article 3.[79]

The available evidence makes clear that Canada, through EDC, makes available export credits for regional aircraft at rates below the relevant CIRR and for terms in excess of 10 years.

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[73] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, para. 181 (2 August 1999) (Adopted 20 August 1999).

[74] WT/DS46/AB/R, para. 179.

[75] WT/DS46/RW, para. 6.91 (emphasis in original).

[76] *Id.*

[77] WT/DS46/AB/R, para. 182.

[78] *OECD Arrangement* (1998), Annex II, Art. 21(a) (Exhibit Bra-42). *See also OECD Arrangement* (1992), Annex IV, Art. 21 (Exhibit Bra-43).

[79] WT/DS46/RW, Annex 1-4, Responses by Canada to Questions of the Panel, Canada's Responses to the Panel's Questions Posed on 3 February 2000,Response to Question 1 (emphasis added) (Exhibit Bra-27).

2. EDC Supplies Export Credits on Terms More Favourable than Those Available Under the *OECD Arrangement*

55. Despite the lack of transparency in Canada's export credit system, publicly available information confirms that Canada, through the EDC, provides export credits that do not comply with the minimum provisions of the Arrangement with regard both to the interest rate and to the repayment term.

56. Canada admits that EDC supplies financing at interest rates below the relevant CIRR. As the Article 21.5 Panel in *Brazil – Aircraft* stated, "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."[80]

57. Canada provided no details of the support it provided below the CIRR, nor did it explain what was "commercial" about it. Canada also admitted, in *Brazil – Aircraft*, that, in at least one instance, it has utilized the "matching" provisions of the *Arrangement*.[81] These permit a participant in the *Arrangement* to derogate from its requirements in order to "match" non-complying terms supported by another export credit agency.[82] The Article 21.5 Panel in *Canada – Aircraft* held, however, that the matching provisions are *not* part of the "interest rates provisions" of the *Arrangement*.[83] Therefore, utilization of the matching provisions, even if in conformity with OECD requirements, does not provide shelter for an otherwise prohibited subsidy. Even Canada, the *Brazil – Aircraft* Panel noted, did "*not* assert that this [matching] transaction was in any sense a market-based transaction."[84]

58. Finally, Minister Tobin himself admitted that Canada utilizes EDC to finance exports of aircraft with interest rates that confer a benefit. He unequivocally described the rate Canada was making available to Air Wisconsin as "a better rate than one would normally get on a commercial lending basis."[85] According to Minister Tobin, Canada is "using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[86]

59. In addition to Canada's admitted practice of supporting exports of regional aircraft at rates below the CIRR, the public record provides evidence that Canada routinely exceeds the *Arrangement's* 10-year maximum repayment term:

- Bombardier's sale of eight CRJs to Kendell Airlines, with financing by EDC, was for a period of 12 years.[87]

- At least a portion of the CRJs purchased by Comair with "government guarantees to the extent available" "were financed through operating leases with terms of up to 16.5 years."[88]

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[80] WT/DS46/RW, para. 6.99.

[81] WT/DS46/RW, para. 6.101.

[82] *OECD Arrangement* (1992), Art. 11 (Exhibit Bra-43); *OECD Arrangement* (1998), Art. 29 (Exhibit Bra-42).

[83] WT/DS70/RW, para. 5.125.

[84] WT/DS46/RW, para. 6.101 (emphasis in original).

[85] Tobin Press Conference, para. 66 (Exhibit Bra-21).

[86] *Id.*, para. 20.

[87] Dominic Jones, "Ready, Steady . . . ," pg. 48 (Exhibit Bra-34).

[88] Comair Holdings, Inc., Form 10-K for the fiscal year ended 31 March 1998, website pagination pg. 33 (Exhibit Bra-39); Comair Holdings, Inc., Form 10-Q for the quarterly period ended 30 June 1998, website pagination pg. 14 (Exhibit Bra-40).

- The US regional carrier Atlantic Coast Airlines Holdings Inc., in a Form 10-K filed with the US Securities and Exchange Commission for the fiscal year ended 31 December 2000, reported that, "On March 14, 2001 the Company acquired through leveraged lease transactions its 41st CRJ aircraft. The lease terms are for approximately 16.8 years."[89]

- In a Form 10-K filed with the US Securities and Exchange Commission for the fiscal year 1998, the US regional airline ASA reported the purchase of more than 90 CRJs, and the delivery of 17 "through operating leases with 16.5 year terms." It then stated, "ASA obtained a commitment from the Export Development Corporation (EDC) of Canada to provide financing to ASA for up to approximately 85 per cent of the purchase price of the 45 CRJ-200 aircraft .... This facility ... is available on an aircraft by aircraft basis in the form of either direct loans or leases, with interest payable at various interest rate options determined by reference to either US Treasury rates or LIBOR, and on various repayment terms."[90]

- In a 10-K filing with the US Securities and Exchange Commission for the fiscal year 1997, Midway Airlines Corp. reported the acquisition of 10 CRJ aircraft, and options for 20 more, for a term of 16.5 years at a rate of 6.9 per cent.[91]

3. Financial Services that "Complement" the Market Confer a Benefit

60. As Brazil noted earlier in this Submission, Canada has admitted that, "EDC *complements* the banks and other financial intermediaries, but cannot substitute for them",[92] EDC's "goal is to help absorb the risk on behalf of Canadian exporters, beyond what is possible by other financial intermediaries".[93] This description makes plain that EDC goes beyond the market in providing services.

61. By definition, a service that "complements" the market provides something that is not available in the market. The ordinary meaning of the word "complement" is "The quantity or amount that completes or fills, the totality".[94] In other words, a "complement" adds something that was not previously present. It does not duplicate what is already there. Similarly, when government "absorb[s] the risk ... beyond what is possible by other financial intermediaries," it is providing something those intermediaries – those *market* intermediaries – do not. All of this is simply another way of saying that EDC provides financial services, including export credits, "on terms that are more advantageous than those that would have been available to the recipient in the market".[95] Thus, all of this is another way of saying that EDC's provision of superior financial services confers a benefit.

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[89] Atlantic Coast Airlines Holdings, Inc., U.S. Securities and Exchange Commission Form 10-K for the fiscal year ended 31 December 2000, website pagination pg. 29 (Exhibit Bra-44).

[90] ASA Holdings, Inc., Form 10-K for the fiscal year ended 31 December 1998, website pagination pg. 48 (Exhibit Bra-38). Brazil would note that the EDC financing referred to in this ASA filing includes floating interest rates at LIBOR. Canada's argument that floating rates are eligible for the safe haven of item (k) second paragraph has been rejected. *See* WT/DS70/RW, paras. 5.102 - 5.106.

[91] Midway Airlines Corp., Form 10-K for the fiscal year ended 31 December 1997, website pagination pg. 30 (Exhibit Bra-41). As noted above, while the filing does not state that EDC was involved in the transaction, Embraer has informed Brazil that its trade sources state that EDC was involved in the financing. Moreover, any information with regard to EDC's involvement is in Canada's sole possession.

[92] EDC Message, pg. 4 (emphasis added) (Exhibit Bra-24).

[93] *Id.*, pg. 2 (emphasis added) (Exhibit Bra-24).

[94] NEW SHORTER OXFORD ENGLISH DICTIONARY 460 (Fourth Ed. 1993).

[95] WT/DS70/R, para. 9.112.

4. Government Provision of Financial Services of a Quality Better than that Available in the Market is a Benefit

62. Before the Panel in the prior proceeding, Brazil quoted the statement of former EDC President Paul Labbé:

> EDC's financing support gives Canadian exporters an edge when they bid on overseas projects. ... Trade deals increasingly depend on complex and tightly negotiated financing arrangements where a few basis points in interest rates can make or break the deal. Exporters are having to bid not just on the basis of quality and price, but also on the basis of the financing package supporting the sale.[96]

63. Brazil argued that Mr. Labbé's statement amounted to an acknowledgement that EDC provided an "edge" to Canadian exporters by "a few basis points," and that this was better than was available in the market.[97] Canada, however, argued that in referring to the "edge" provided by EDC, Mr. Labbé simply was referring to "the ability of EDC officials to assemble better structured financial packages on the basis of their knowledge and expertise".[98] The Panel concluded, and the Appellate Body agreed, that "this statement provides no firm guidance as to whether the EDC provides exporters with an 'edge' through subsidization."[99]

64. Subsequent statements by EDC officials echo Mr. Labbé's point. For example, his successor, Mr. Ian Gillespie, lauds the "skills and experience" of EDC's employees, and notes that, "EDC houses the largest pool of trade finance skills under one roof in Canada."[100]

65. The issue before the Panel in the prior proceeding concerned only financial contributions within the meaning of subparagraph (i) of Article 1.1(a)(1) – direct financing (loans), equity infusions, and guarantees. That proceeding did not involve the question of subparagraph (iii) of Article 1.1(a)(1) – the provision by government of services other than general infrastructure.[101] This proceeding explicitly involves both subparagraph (i) and subparagraph (iii).

66. Brazil continues to believe that the most reasonable interpretation of the ordinary meaning of Mr. Labbé's words is that they admit that EDC provides support in the form of credits "a few basis points" below the market. We are told, however, that by referring to an "edge" amounting to a "few basis points", Mr. Labbé merely was referring to "the ability of EDC officials to assemble *better structured financial packages* on the basis of their *knowledge and expertise*". If so, there is still a benefit. Government provision of ability, knowledge and expertise through financial services superior to those the recipient otherwise could obtain in the market – through "better structured financial packages" – also constitutes the conferral of a benefit.

67. Despite Canada's claim that EDC is just another bank, these skills, this "knowledge and expertise", this ability "to assemble better structured financial packages", are made available *only* to Canadian exporters. In the field of regional aircraft, only Bombardier may take advantage of the "edge" EDC provides through its superior services. Embraer is not eligible. Nor is any other player in the market eligible for these services which are, by Canada's own description, superior to those available in the market to Bombardier, its customers, and everyone else. Thus, through its admitted provision of services superior to those available in the market, other than general infrastructure, only to Canadian firms and their customers, EDC provides a benefit to those firms.

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[96] WT/DS70/R, para. 6.57.
[97] WT/DS70/R, para. 6.58.
[98] WT/DS70/R, para. 9.163.
[99] WT/DS70/R, para. 9.164; WT/DS70/AB/R, para. 213.
[100] EDC 2000 Annual Report, pg. 4 (Exhibit Bra-22).
[101] *See, e.g.*, WT/DS70/R, paras. 6.1 - 6.6.

5. Government Supported Guarantees Confer a Benefit

68. A guarantee reduces the risk in a transaction. Even if the guarantor's credit rating is the same as, or even lower than, that of the party whose performance is being guaranteed, the addition of the guarantor to the transaction will reduce risk simply by adding another party to those responsible should the guaranteed event not occur

69. In most circumstances, the credit rating of guarantor will be superior to that of the party whose performance is being guaranteed. This is particularly true when a government provides a guarantee. As Canada stated to another Panel that was considering a guarantee provided by the United States Export-Import Bank, "In such circumstances, the lending bank establishes financing terms in the light of the risk of the US Government, not the borrower".[102]

70. Provision of a guarantee, as well as government substitution of its own credit rating for that of a borrower through a guarantee, both permit a borrower to obtain funds on terms more favourable than it otherwise could obtain them in the market, and confers a benefit.

E. EDC IS CONTINGENT UPON EXPORT

71. EDC "was established ... for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[103] Consequently, EDC subsidies are "contingent in law ... whether solely or as one of several other conditions, upon export performance", within the meaning of Article 3.1 (a) of the SCM Agreement.

72. The extent to which EDC will go in providing financial services to support sales by Canadian exporters on terms more favourable than those available in the market is illustrated by Bombardier's launch sale of its regional jet in the early 1990s. This sale was to Air Canada and therefore, ostensibly, was a domestic sale. Seemingly, therefore, the *Export* Development Corporation would not be involved. But EDC was involved. When questioned by Parliament with regard to the apparent irregularity of EDC's financing a sale to Air Canada, Mr. Labbé stated that the sale indeed was an "export" sale. A "tax vehicle" had been established in the United States, he said, and the export sale had been made to this "tax vehicle," which, in turn, leased the aircraft to Air Canada.[104] Why did EDC go to all this trouble to finance what should have been a purely domestic sale? Mr. Labbé explained: "Our focus is export financing. *What we're trying to do* in this particular case – this is an exceptional case – *is launch an aircraft that has a world market*".[105]

F. CANADA PROVIDES PROHIBITED SUBSIDIES THROUGH EDC

73. The publicly available evidence, as noted in Brazil's 21 May letter to the Panel, is only the tip of the iceberg. Nonetheless, this evidence makes clear that, through EDC, and, in particular its market window operations, Canada provides prohibited export subsidies. EDC was established to support exports by providing financial services that the market does not provide. EDC "complements" the market. It provides interest rates below the CIRR and for terms that exceed 10 years. Yet the CIRR and 10 years are, in the words of the *OECD Arrangement*, "the most generous repayment terms and conditions that may be supported". The Appellate Body has concluded that terms more generous than

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[102] WT/DS46/RW, Annex 1-2, para. 36.

[103] Export Development Act, Section 10(1) (Exhibit Bra-17); EDC 2000 Annual Report, pg. 47 (Exhibit Bra-22).

[104] Testimony of EDC Officials, House of Commons of Canada, 35th Parliament, 1st Sess., Standing Committee on Foreign Affairs and International Trade, Meeting No. 43, pg. 43:30 (Exhibit Bra-45).

[105] *Id.* (emphasis added).

those provided by the *OECD Arrangement* are positive evidence of a material advantage; such terms are, *a fortiori*, positive evidence of a benefit. EDC, by its own description, provides financial services to Canadian exporters – and only to Canadian exporters – superior to these and superior to those the exporters could obtain elsewhere. Provision of these services is contingent in law upon export. They therefore constitute a prohibited export subsidy.

IV. CANADA ACCOUNT

74. The Canada Account was, and remains, a prohibited export subsidy. It is also a measure shrouded in secrecy. Until the 10 January press conference by Minister Tobin with respect to the Air Wisconsin transaction, virtually nothing has been said or disclosed by Canada concerning the Canada Account since Brazil's initial challenge to the measure began. The news release issued in connection with Minister Tobin's 10 January press conference described Canada Account and its relationship to EDC:

> The Export Development Corporation (EDC) has a mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities. The Corporation is financially self-sufficient and is accountable to Parliament through the Minister for International Trade.
>
> For transactions that are in the national interest but can not be supported directly by EDC for reasons such as high risk or size, the Corporation may refer them for consideration under Canada Account. In these cases, the Corporation administers the transaction but the risks ultimately rest with the Canada Account.
>
> EDC must obtain the authorization of the Minister for International Trade, with the concurrence of the Minister of Finance, before Canada Account transactions can be signed. Transactions valued at more than $50 million are referred to Cabinet for authorization. In all cases, the financing support is extended on terms which are consistent with our international export credit obligations under the OECD Arrangement on officially supported export credits.[106]

75. The Panel in *Canada – Aircraft* found that the Canada Account constituted a subsidy within the meaning of Article 1 of the SCM Agreement in that it was a financial contribution and conferred a benefit.[107] The Panel also found that Canada Account subsidies were contingent in law on export performance within the meaning of Article 3.1(a) of the SCM Agreement,[108] and therefore were prohibited by Article 3.2 of the Agreement.[109] Nothing has occurred since that time that would alter that conclusion.

76. Following adoption of the report in *Canada – Aircraft*, Canada attempted to shelter the Canada Account in the safe haven of the second paragraph of item (k) to Annex I of the SCM Agreement. This attempt was rejected by the Article 21.5 Panel that considered the issue.[110] In particular, Canada attempted to conform the Canada Account to its WTO obligations by agreeing to comply with the entire *OECD Arrangement*, including its matching provisions. The Panel, noting that item (k) referred only to the "interest rates provisions" of the *Arrangement*, and not to all of its provisions, explicitly disagreed with Canada.[111] Yet, it was these same matching provisions to which

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[106] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 (Exhibit Bra-3).

[107] WT/DS70/R, paras. 9.221, 9.224, 9.226.

[108] WT/DS70/R, para. 9.230.

[109] WT/DS70/R, para. 9.231.

[110] WT/DS70/RW, para. 6.2.

[111] *See, e.g.*, WT/DS70/RW, para. 5.125.

Minister Tobin referred in his press conference when asked to justify Canada's actions.[112] The $2.35 billion Air Wisconsin deal was confirmed by Bombardier on 16 April 2001, with International Trade Ministry spokesman Sebastian Theberge stating that "the deal is in essence the one announced [by Mr. Tobin]".[113]

77. Canada's use of the Canada Account to support Bombardier's sale of aircraft to Air Wisconsin constitutes a prohibited subsidy.

A. CANADA ACCOUNT PROVIDES A FINANCIAL CONTRIBUTION

78. Canada Account offers four major financial services to support Canadian exporters: export credits insurance, financing services, performance insurance, and political risk insurance.[114] These constitute either a "direct transfer of funds" or a "potential direct transfer of funds or liabilities," under Article 1.1(a)(1)(i) to the SCM Agreement. In discussing Canadian support for the Air Wisconsin transaction, Minister Tobin stated that it would take the form of a "loan," which constitutes a direct or potential direct transfer of funds, within the meaning of Article 1.1(a)(1)(i).[115] All of these export credits, whatever their form, also constitute the provision of services other than general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the Agreement.

B. CANADA ACCOUNT CONFERS A BENEFIT

79. The Appellate Body held in *Canada – Aircraft* that a benefit arises whenever a financial contribution confers "terms more favourable than those available to the recipient in the market".[116] As noted above, for example, Minister Tobin acknowledged that Canada is providing Air Wisconsin with "a better rate than one would normally get on a commercial lending basis".[117] Moreover, the Minister stated that Canada was in this instance "using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier".[118] Both of these statements demonstrate that, through Canada Account support, Canada is conferring on the participants in the Air Wisconsin transaction terms more favourable than those available to them in the market, and therefore is conferring a benefit.

C. CANADA ACCOUNT SUPPORT IS CONTINGENT UPON EXPORT

80. EDC's website confirms that "[t]he Canada Account is used to support export transactions ...".[119] Moreover, "[t]he basic objectives of the Canada Account programme are identical to those of EDC's Corporate Account. However, under the Canada Account programme, EDC is able to support *export* transactions which, on the basis of prudent risk management, could not be supported under the Corporate Account".[120] Similarly, the Canada Account "backgrounder" accompanying Industry Canada's announcement of its support for the Air Wisconsin deal states that Canada Account is one

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[112] Tobin Press Conference, paras. 7, 15, 20, 27, 74, 126 (Exhibit Bra-21).

[113] "Bombardier cranks up job mill after signing $2.35-billion jet deal: Federal subsidy gives U.S. airline below-market rate," *Ottawa Citizen*, 17 April 2001 (Exhibit Bra-14). *See also* "Bombardier signs contract with Air Wisconsin for up to 150 CRJ200 regional jets," *Bombardier Press Release*, 16 April 2001 (Exhibit Bra-15).

[114] EDC SUMMARY REPORT TO TREASURY BOARD ON CANADA ACCOUNT OPERATIONS FISCAL YEAR 1998/1999, pg. 4 ("EDC SUMMARY REPORT") (Exhibit Bra-46). EDC's website confirms that Canada Account continues to provide "insurance coverage, financing and guarantees." EDC website, "How We Work" (Exhibit Bra-16).

[115] Tobin Press Conference, paras. 46, 48, 50 (Exhibit Bra-21).

[116] WT/DS70/AB/R, para. 158.

[117] Tobin Press Conference, para. 66 (Exhibit Bra-21).

[118] *Id.*, para. 20.

[119] EDC website, "How We Work" (Exhibit Bra-16).

[120] EDC SUMMARY REPORT, pg. 4 (emphasis added) (Exhibit Bra-46).

way for EDC to satisfy its "mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[121] The Canada Account remains, therefore, *de jure* contingent upon export.

D. CANADA PROVIDES PROHIBITED SUBSIDIES THROUGH THE CANADA ACCOUNT

81. Canada's use of the Canada Account, in the face of its earlier pledge to the DSB – "Canada wishes to inform the DSB that there will be no deliveries of regional aircraft after 18 November 1999 benefiting from such Canada Account Financing".[122] – is particularly regrettable. The statement of Minister Tobin, the press release accompanying his press conference, and the subsequent confirmation by Mr. Theberge upon completion of the transaction, make plain that the Air Wisconsin transaction was made with Canada Account support. The Canada Account provides a financial contribution, and thereby confers a benefit. It is contingent upon export. Accordingly, it remains a prohibited subsidy.

V. INVESTISSEMENT QUEBEC

82. On 31 March 1998, Quebec's Deputy Prime Minister, Mr. Bernard Landry, in a Budget Speech to the National Assembly, announced the establishment of IQ as the successor to the Société de développement industriel du Quebec ("SDI").[123] SDI was formed with the objective "to promote economic development in Quebec, particularly by encouraging the development of businesses, the growth of exports, research and the development of new techniques."[124] SDI, and its mandate, were "incorporated into the new government corporation", i.e., IQ.[125]

83. The "general mission" of IQ "is to facilitate the growth of investment in Québec and thus contribute to the economic development of Québec and the creation of employment opportunities".[126] More specifically, Article 25 of *An Act Respecting Investissment-Québec and Garantie-Québec* ("IQ Act") provides, "The agency shall participate in the growth of enterprises, in particular by facilitating research and development and export activities".[127]

84. IQ's powers are broad. The IQ Act provides that, "where a project is of major economic significance for Québec", the Government may "mandate the agency to grant and administer the assistance determined by the Government to facilitate the realization of the project".[128] The IQ Act not only authorizes the agency to furnish "financial intervention" in the form of guarantees ("suretyship") and loans, it also authorizes "any other form of intervention provided for in its business plan".[129]

85. In an article concerning the Air Wisconsin transaction, the Montreal Gazette of 11 January 2001 reported on one example of IQ's activities:

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[121] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 (Exhibit Bra-3).

[122] *Canada – Measures Affecting the Export of Civilian Aircraft – Status Report by Canada*, WT/DS70/8 (26 November 1999).

[123] 1998-1999 Budget Speech, Delivered before the National Assembly by Mr. Bernard Landry, Deputy Prime Minister and Minister of State for the Economy and Finance, 31 March 1998, pg. 24 ("1998-1999 Budget Speech") (Exhibit Bra-47).

[124] An Act Respecting the Société de Développement Industriel de Québec, Art. 2 (Exhibit Bra-48).

[125] 1998-99 Budget Speech, pg. 24 (Exhibit Bra-47).

[126] An Act Respecting Investissement-Québec and Garantie-Québec ("IQ Act"), Art. 25 (Exhibit Bra-18).

[127] *Id.*

[128] *Id.*, Art. 28.

[129] *Id.*, Art. 30.

> In addition to federal aid, Bombardier also secured $226 million from Investissement Québec in loan guarantees partly for the deal with Air Wisconsin, a regional feeder carrier affiliated with Chicago's United Airlines.
>
> IQ spokesman Jean Cyr said that in 1996 the provincial investment fund created a five-year $450-million programme to provide loan guarantees to Bombardier's customers. About $300 million of that has been used, and Cyr said that on Dec. 20, Bombardier "came to us and said they were negotiating this big deal with Air Wisconsin that would require" more than the remaining $150 million.
>
> So the provincial cabinet approved another $76 million, making a total of $226 million available to airlines that buy Bombardier aircraft. That entire sum will not go entirely to the Air Wisconsin deal, Cyr said.[130]

86. IQ's support of Bombardier is not confined to loan guarantees for its customers. IQ also provides what Brazil understands are sometimes called "first loss deficiency guarantees". These unusual instruments protect equity investors in corporations established to purchase aircraft from Bombardier and lease the aircraft to an airline, particularly in what are known as "leveraged lease" transactions. A "leveraged lease" takes advantage of the tax laws of the country in which the corporation is established in order to lower the lease payment required of the airline customer. The term "leverage" refers to the use of tax savings to reduce lease payments.

87. For example, investors may establish a corporation to purchase aircraft from a manufacturer in order to lease the aircraft to an airline. The transaction normally will have been arranged by the manufacturer's sales department, since this device is a way to facilitate sales. The investors provide 20 per cent of the capital of the corporation and the remaining 80 per cent is borrowed from banks or other financial institutions. The aircraft are then purchased and serve as collateral to secure the debt. The lease payments from the airline are used to retire the debt. Little or nothing is paid during the life of the lease to the investors. Thus, the amount of the lease need only be enough to pay the debt, which represents only 80 per cent of the value of the aircraft. The return to the equity investors comes from two sources: (1) tax write-offs and (2) the residual value of the aircraft.

88. The tax laws of some countries – particularly France, Germany, Japan, the United Kingdom and the United States – favour this type of transaction. As the owners of the aircraft, even though they supplied only 20 per cent of the purchase price, the investors – under the tax laws of these countries – are entitled to apply 100 per cent of the annual depreciation on the aircraft against their income from other sources. Thus, the "paper" losses through depreciation of the aircraft serve to lower the current tax bill of the investors over the life of the lease. In addition, when the debt is retired and the lease is terminated, the investors are the owners of the aircraft and are able to claim what is called its "residual value". The profits realized from any sale of the aircraft at this point are treated as "capital gains" and are taxed at a lower rate in jurisdictions whose tax laws favour this type of transaction.

89. The investors face two major risks. One is that the aircraft may have little value at the end of the lease. Investors usually are protected from this risk by the strict maintenance requirements that apply to aircraft, and by a "residual value guarantee" usually provided by the manufacturer.[131] The

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[130] "Ottawa backs Bombardier: Loan to U.S. firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9).

[131] Embraer has reported to the Government of Brazil that its sales personnel have been told by potential airline customers that Bombardier offers a government-backed residual value guarantee. However, Brazil has no documentation to support these statements. This information is within the sole possession of Canada, as noted in Brazil's letter to the Panel of 21 May 2001.

other risk faced by the investors is default by the airline during the life of the lease. Should default occur, the creditors – those who furnished the 80 per cent debt capital of the corporation – would be entitled to repossess the aircraft to satisfy their claims. This would deny the investors the benefit of tax write-offs from that point forward. It also could deprive them of their assets – the aircraft – when the aircraft are sold to satisfy the claims of the debtors. The price realized at sale may not be sufficiently in excess of the amount necessary to satisfy the debt, and therefore leave the investors with a partial or even a full loss. A first loss deficiency guarantee protects investors from this risk.

90. On at least one occasion, IQ has offered such a guarantee to equity investors in a corporation established to purchase Bombardier aircraft. Brazil's Exhibit 49 is a portion of a memorandum to potential equity investors in a corporation to be established to purchase and lease aircraft manufactured by Bombardier. The memorandum states that the transaction will involve a leveraged lease with a term of up to [] years. It then specifies:

[[132]]

91. While this transaction is the only documentary evidence currently available to Brazil concerning IQ's investment guarantees, Brazil has been informed by Embraer that Quebec provided support, which Embraer believes was in the form of equity guarantees, to facilitate Bombardier sales of CRJ 200 regional jets to Atlantic Southeast, Midway, and Northwest Airlines during the late 1990s. Any information with regard to these transactions is solely within Canada's possession. That information is included in Brazil's 21 May letter to the Panel requesting that the Panel ask Canada to provide relevant information.

A. IQ PROVIDES A FINANCIAL CONTRIBUTION TO REGIONAL AIRCRAFT

92. The provision of financial services in the form of loans and guarantees ("suretyship") constitute financial contributions within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. These would include the specific examples cited by Brazil: the guarantee described by M. Cyr and the guarantee provided to equity investors. These financial services also constitute services other than general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the Agreement.

B. IQ PROVIDES A BENEFIT TO REGIONAL AIRCRAFT

93. The words of the [] – echo the words of Canada in the *Brazil – Aircraft* Article 21.5 review, that, in the case of loan guarantees, "the lending bank establishes financing terms in the light of the risk of the [government], not the borrower".[133] In this case, there does not appear to be a loan guarantee, only an equity guarantee. But the principal is the same. The full faith and credit of the Government of Quebec insures the equity investors against loss.

94. Indeed, a guarantee to equity investors is an even greater benefit than a loan guarantee. Equity investors normally are the risk takers in a transaction. In exchange for the potential rewards of ownership, they take the risk of failure. A guarantor that removes or reduces this risk accepts the entire risk of the market system with no potential for its rewards. A guarantor of a loan, in contrast, normally has the security of the loan collateral to reduce its exposure, plus the fact that over time, as the loan is amortized, that exposure is reduced. A guarantor of an equity investor does not enjoy even this security. Indeed the reverse might be the case, since the entire capital contributed by the equity investors is at risk throughout the lease.

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[132] [] (Exhibit Bra-49). Under the terms of Article 16 of the Panel's Working Procedures, Brazil requests that this confidential bracketed quotation be excluded from the version of this submission attached to the Panel Report.

[133] WT/DS46/RW, Annex 1-2, para. 36.

95. So unusual are equity guarantees that they are not even mentioned by name in the text of the Agreement, as are loan guarantees. Beyond this, they do not even appear to be available commercially. After being told by potential customers that Bombardier was able to offer potential investors in leasing corporations a guarantee, Embraer made inquiries to determine whether it could obtain similar guarantees. Embraer was told that these guarantees are not available in the market.[134]

96. A government loan guarantee confers the government's credit rating on a private party and thereby confers a benefit by making a borrower more credit worthy than it otherwise would be in the market. Totally apart from a potentially more favourable credit rating, however, a loan guarantee adds to the security of lender by making an additional party responsible for the debt. This also confers a benefit by making any borrower more credit-worthy than it otherwise would be. Government guarantee to an equity investor, protecting that investor from the risks inherent in the equity market, confers a benefit by making equity capital available to finance aircraft transactions on terms more favourable to the other parties than would be the case in the market in the absence of the guarantee.

C. IQ IS CONTINGENT UPON EXPORT

97. Article 25 of the IQ Act specifies "export activities" as one of the missions of IQ. IQ regulations confirm that the programme is contingent in law upon export.

98. While IQ can support a variety of projects, where a project is related to the sale of goods such as aircraft, receipt of IQ funds is explicitly contingent on the export of those goods. Decree 572-2000, regarding the fund for private sector investment growth, enables IQ to provide financial support for investment projects or export projects.[135] The Decree then specifies that "exportation" includes, among other things, the sale of goods, but only if that sale is outside of Quebec.[136] Similarly, Decree 841-2000 grants IQ authority to support market development projects,[137] which it defines to include, among other things, projects ultimately focused on the sale of goods, but again only if the sales at issue are outside of Quebec.[138]

99. Thus, wherever IQ supports the sale of aircraft, it does so only on the condition that the recipient export those aircraft outside of Quebec. This is the very definition of "contingent in law . . . upon export performance", within the meaning of Article 3.1(a) of the SCM Agreement. As a matter of law, a potential recipient must demonstrate that the aircraft will be exported. In every instance in which it is used to support regional aircraft transactions, therefore, IQ is, as such, a prohibited export subsidy.

100. IQ's regulations contain further evidence of its export contingency. Decree 841-2000 provides for financing to support something called an "export credit margin":

> The level of an export credit margin is determined according to the short-term financing needs of the firm and the guarantee is accorded according to the market

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[134] *See* bank letters included in Exhibit Bra-50.

[135] Décret 572-2000, 9 mai 2000, Concernant le programme du Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi, Art. 1 (Exhibit Bra-19).

[136] *Id.*, Art. 2.

[137] Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises, Art. 2 (Exhibit Bra-20).

[138] *Id.*, Art 3 ("'développement de marchés': . . . – la commercialisation . . . pour l'accroissement de ventes . . . à l'extérieur du Québec; – la vente de biens . . . à l'extérieur du Québec; – l'acquisition d'une entrepirse ou d'un réseau de distribution pour la vente de biens . . . à l'extérieur du Québec; – la formation d'un groupement d'entreprises à des fins de vente de biens . . . à l'extérieur du Québec . . . .").

development activities of the firm and of *the Quebec content of the products and services that it exports*.[139]

101. The loan guarantee fund established in 1996 specifically for Bombardier and the equity guarantee provided by Quebec for investors further demonstrate the *de jure* export contingency of IQ's subsidies. Virtually all of Bombardier's regional aircraft production is exported. Even the launch sale to the domestic carrier, Air Canada, was structured as an export sale and received financing from EDC.[140] To paraphrase the Panel in *Australia – Leather*, it is clear that the Canadian market for aircraft is too small to absorb Bombardier's production, much less any expanded production that might result from the financial benefits accruing from subsidies.[141]

102. IQ's export contingency is further demonstrated by the equity guarantees IQ furnishes to support leveraged lease transactions.[142] The very purpose of leveraged lease transactions is to take advantage of the favourable tax treatment provided by the laws of the jurisdiction of ownership. The tax laws of five countries – France, Germany, Japan, the United Kingdom, and the United States – cause almost all, if not all, of the world's leveraged lease transactions to be based on one of them. The tax laws of Canada virtually assure that no leveraged lease will be based in Canada. In fact, "tax-based lease financing, other than for certain exempt property, is almost non-existent" in Canada.[143] In this regard, Brazil recalls the testimony of Mr. Paul Labbé, the then-president of EDC, who, in justifying EDC's support of a seemingly domestic sale to Air Canada, told the Canadian Parliament that a "tax vehicle" had been established in the United States, and that this "tax vehicle" acquired the aircraft, thereby qualifying the transaction as an export, and then leased the aircraft to Air Canada.[144]

D. CANADA PROVIDES PROHIBITED SUBSIDIES THROUGH IQ

103. The publicly available evidence concerning the operations of IQ, like the publicly available evidence concerning EDC, is only the tip of the iceberg.[145] Nonetheless, that evidence makes clear that, at a minimum, through IQ guarantees, Canada provides prohibited export subsidies. Those guarantees are financial contributions that confer a benefit by absorbing risk that would otherwise fall upon the participants in the transactions. They are contingent, in law or in fact, upon export. They are, therefore, prohibited by the Agreement.

VI. CONCLUSION

104. This is a dispute about subsidies, but it is more than that. As a subsidies dispute, the activities of EDC, the Canada Account, and IQ are at issue. The evidence Brazil has presented demonstrates conclusively that, through each of these mechanisms, Canada provides a subsidy that is contingent upon export, and Brazil requests that this Panel so determine, as set out in Brazil's request for the establishment of the Panel.

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[139] Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises, Art. 7 (English translation) (Exhibit Bra-20).

[140] *See supra* para. 72.

[141] *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, para. 9.67 (25 May 1999) (Adopted 16 June 1999) ("[I]t is clear that the Australian leather market for automotive leather is too small to absorb Howe's production, much less any expanded production that might result from the financial benefits accruing from the grant payments . . .").

[142] Offering Memorandum (Exhibit Bra-49).

[143] Monica Biringer, "Cross-Border Equipment Leasing May Reduce Financing Costs for Canadian Users," 5 *Journal of International Taxation* 230 (May 1994) (Exhibit Bra-51).

[144] Testimony of EDC Officials, House of Commons of Canada, 35th Parliament, 1st Sess., Standing Committee on Foreign Affairs and International Trade, Meeting No. 43, pg. 43:30 (Exhibit Bra-45).

[145] *See supra* para. 73.

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105. At a broader level, however, this is a dispute about transparency and the functioning of the WTO dispute settlement system as it relates to subsidies. None of the Canadian programmes that are the subject of this dispute has even been notified to the Committee on Subsidies and Countervailing Measures pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement.[146] At consultations, Canada declined to provide information in response to Brazil's questions, and, indeed, Canada's delegation to the consultations stated that it was totally unprepared even to talk about IQ. In the prior proceeding, Canada adamantly refused to cooperate in providing relevant information in its sole possession, even when requested to do so by the Panel. Canada went so far as to argue that it had no duty to cooperate.[147]

106. Thus, what is at issue here is not only the consistency or inconsistency of Canada's programmes with its WTO obligations, but, perhaps even more important, the consistency or inconsistency of Canada's obligations of transparency and good faith cooperation. The Panel's determination on the merits of this dispute will have very important implications for the standards that apply to export credits in the WTO. The Panel's determination on the issues of transparency and good faith that have been raised by Canada's stance in this and in the prior dispute will have very important implications for the standards that apply not just to export credits, but to all disputes in the WTO.

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[145] *See supra* para. 73.

[146] The latest Canadian notification is dated 9 May 2000. G/SCM/N/48/CAN. Perhaps Canada's next notification will rectify the apparent oversight.

[147] WT/DS70/AB/R, para. 186.

ANNEX A-4

RESPONSE OF BRAZIL TO SUBMISSION OF CANADA REGARDING JURISDICTIONAL ISSUES

(22 June 2001)

1. The Panel has asked Brazil to respond to Canada's preliminary submission regarding the Panel's jurisdiction, dated 18 June 2001.[1] In that submission, Canada claims that certain of Brazil's claims are inconsistent with Articles 6.2 and 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU").

I. BRAZIL'S CLAIMS WITH RESPECT TO THE CANADA ACCOUNT ARE CONSISTENT WITH ARTICLE 21.5 OF THE DSU

2. Canada argues that Brazil cannot challenge, in proceedings brought pursuant to Article 6 of the DSU, the existence or consistency with the covered agreements of measures taken to comply with the earlier recommendations and rulings of the DSB with respect to Canada Account.[2] Rather, Canada states that Brazil's only recourse is to Article 21.5 of the DSU. Canada's conclusion is in error, on both factual and legal grounds.

3. As a factual matter, Canada's conclusion that three of Brazil's "claims" would "require this Panel to adjudicate issues of compliance with the earlier DSB rulings in a different case" is also factually incorrect.[3] Canada is incorrect to identify each of the numbered paragraphs regarding the Canada Account in Brazil's request for establishment of this Panel as a separate "claim."[4] Brazil's makes one overarching claim in its request for establishment with respect to Canada Account support, in numbered paragraph 1; namely, that "[e]xport credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3" of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

4. Numbered paragraphs 2 through 4 explain the nature of that claim in more detail. Those paragraphs explain that Brazil is challenging Canada Account support to the regional aircraft industry both as such and as applied in the Air Wisconsin transaction. In paragraph 2, Brazil asks the Panel to find that the Article 21.5 Panel in the *Canada – Aircraft* dispute found the Canada Account to be inconsistent with Article 3 of the SCM Agreement[5] but that, despite this, to date, Canada has done nothing to rectify this inconsistency. The references in paragraphs 1 and 3 to the continuing nature of the export subsidization effected by the Canada Account are specific assertions requesting findings of fact by the Panel regarding the as yet unamended Canada Account. Canada itself, in its first written submission, refers to the history of the *Canada – Aircraft* dispute with respect to the Canada Account.[6]

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[1] This submission is hereafter referred to as "Canada's Preliminary Submission".

[2] *See Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (Adopted 4 August 2000), para. 6.2.

[3] Canada's Preliminary Submission, para. 15.

[4] WT/DS222/2 (1 March 2001).

[5] WT/DS70/RW (Adopted 4 August 2000), para. 6.1.

[6] Canada's First Written Submission to the Panel, dated 18 June 2001, paras. 30-31.

5. In addition, Canada's arguments fail on legal grounds. While it is indeed the case that a Member may challenge "measures taken to comply" with the recommendations and rulings of the DSB under Article 21.5 of the DSU, the ordinary meaning of Article 6.2 of the DSU and Articles 4.1, 4.4 and 4.5 of the SCM Agreement do not preclude a Member from similarly bringing a new dispute settlement proceeding under those provisions.

6. Article 6.2 of the DSU refers generically to "measures" that are the subject of a request for the establishment of a panel. Similarly, Article 4.1 of the SCM Agreement subjects to dispute settlement "a prohibited subsidy . . . granted or maintained by another Member." Article 4.4 states that unsuccessful consultations may result in referral of "the matter" to the DSB for the establishment of a panel. Finally, Article 4.5 authorizes a panel to request assistance from the Permanent Group of Experts regarding whether "the measure in question" is a prohibited subsidy. Nothing in the ordinary meaning of these provisions limits dispute settlement thereunder to *particular types of measures*; nor does the ordinary meaning of these provisions preclude review of "measures" that remain in place with no effort to comply with earlier recommendations and rulings of the DSB.

7. Moreover, even where steps have been taken to comply, the object and purpose of the expedited proceedings provided by Article 21.5 of the DSU would be undermined by Canada's claim. In discussing the meaning of the phrase "consistency with a covered agreement" in Article 21.5, the Panel in *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 by Canada* emphasized that the purpose behind Article 21.5 is to offer *expedited* relief for a Member that has already successfully challenged another Member's measures:

> The *rationale* behind this is obvious: a complainant, after having prevailed in an original dispute, should not have to go through the entire DSU process once again if an implementing Member in seeking to comply with DSB recommendations under a covered agreement is breaching, inadvertently or not, its obligations under other provisions of covered agreements. In such circumstances an expedited procedure should be available. This procedure is provided for in Article 21.5. It is in line with the fundamental requirement of 'prompt compliance' with DSB recommendations and rulings expressed in both Article 3.3 and Article 21.1 of the DSU.[7]

It should be noted that the Panel stated that an expedited procedure is "*available*" to a Member, *not* that it is either compulsory or the sole procedure available. Thus, if that Member chooses to forego those expedited procedures, it is certainly its prerogative to do so. Requiring Members to avail themselves of only those expedited procedures would be contrary to the object and purpose of Article 21.5.

8. In the circumstances of this particular case, Brazil considered it efficient to forego Article 21.5's expedited procedures. Brazil's challenge to Canada Account support for the Canadian regional aircraft industry involves claims against the measure both as such and as applied in particular transactions. Moreover, a panel constituted under Article 21.5 of the DSU to conduct review of "measures taken to comply" with the recommendations and rulings of the DSB with respect to the Canada Account would not be authorized to review the consistency with the covered agreements of Canada Account support as applied in particular regional aircraft transactions. As stated by both Brazil and Canada before a meeting of the Appellate Body in *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*,[8] support granted in transactions subsequent to an implementation deadline are not "measures taken to comply" with the recommendations and rulings of the DSB.

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[7] WT/DS18/RW (Adopted 20 March 2000), para. 6.10.
[8] WT/DS70/AB/RW (Adopted 4 August 2000).

9. Therefore, to consolidate the review of its "as such" and "as applied" claims, Brazil considered it preferable to bring all of those claims before this Panel, rather than bringing some of those claims before an Article 21.5 panel. To require Brazil to have split its claims between two panels – one constituted under Article 21.5 and one under Article 6 – would not be justified by the ordinary meaning of the provisions concerned, and would not be consistent with the object and purpose of Article 21.5 of the DSU.

10. This is particularly true where, as here, no measure to comply has been taken. Here, Brazil has not challenged a measure taken to comply under Article 21.5, but rather has chosen to challenge Canada Account anew as a "measure" under Article 6.2, in accordance with the ordinary meaning of that provision.

11. Finally, following adoption of the Article 21.5 Report, Brazil chose not to exercise its rights, under Article 22.6 of the DSU, to suspend concessions. Instead, it chose to negotiate with Canada with a view to resolving these disputes. In the meantime, the 30-day period for requesting authorization to suspend concessions under Article 22.6 passed. Certainly, Canada does not suggest that at this time Brazil could ask the Dispute Settlement Body for authority to suspend concessions based upon either the previously-adopted reports or any new Article 21.5 report. Yet, if Brazil were not permitted to seek a new determination from a new Panel, that would mean that any Member that initially chose negotiation over retaliation would forever forego the opportunity to suspend concessions. This is not an interpretation that would further the cause of amicable dispute settlement.

12. Brazil therefore requests that Canada's preliminary request be denied in this respect.

II. BRAZIL'S REQUEST FOR ESTABLISHMENT OF THIS PANEL IS CONSISTENT WITH ARTICLE 6.2 OF THE DSU

A. LEGAL OBLIGATIONS UNDER ARTICLE 6.2 OF THE DSU

13. In its preliminary submission, Canada also argues that certain of Brazil's "claims" are inconsistent with the requirements established by Article 6.2 of the DSU.

14. Before reviewing the requirements of Article 6.2 and Brazil's compliance with those requirements, Brazil notes again that Canada is incorrect to identify each of the numbered paragraphs in Brazil's request for establishment of this Panel as a separate "claim". Brazil makes one overarching claim in its request for establishment with respect to Canada Account support, in numbered paragraph 1. Numbered paragraphs 2 through 4 give more detail. Similarly, Brazil's overarching claim with respect to support by the Export Development Programme is included in numbered paragraph 5, with the purpose of paragraph 6 being to demonstrate that Brazil's challenge is both to the particular forms of EDC support discussed in paragraph 5 as such, and to EDC support as applied.

B. BRAZIL'S REQUEST FOR ESTABLISHMENT OF THIS PANEL SATISFIES THE REQUIREMENTS OF ARTICLE 6.2 OF THE DSU

15. Brazil's request for establishment of this Panel satisfies the requirements of Article 6.2 of the DSU, which provides that:

> The request for establishment of a panel shall be in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.
> . . .

16. The Appellate Body has on several occasions described the purpose behind the requirements of Article 6.2. In *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, the Appellate Body stated that "precision" in a request for establishment is important for two reasons:

> First, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and, second, it informs the defending party and the third parties of the legal basis of the complaint.[9]

17. In *Brazil – Measures Affecting Desiccated Coconut*, the Appellate Body referred to these same two purposes in slightly different terms. The Appellate Body stated that a "specific" request for establishment establishes the "jurisdiction of the panel by identifying the precise claims at issue in the dispute", and fulfills a "due process objective", facilitating a response to the complainant's case by other parties and third parties.[10]

18. To fulfill these dual objectives, in its Report in *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, the Appellate Body imposed four specific requirements on a request for establishment:

> The request must: (i) be in writing; (ii) indicate whether consultations were held; (iii) identify the specific measures at issue; and (iv) provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.[11]

As shown below, Brazil's request meets each of these criteria.

1. Requirements (i) and (ii)

19. Brazil's request for establishment of this Panel is in writing, and indicates that consultations were held but did not resolve the dispute. Thus, the first two requirements set out in *Korea – Dairy* are satisfied.

2. Requirement (iii)

20. Brazil's request also satisfies the third requirement discussed in *Korea – Dairy*; namely, that the request for establishment identify the specific measures at issue. For the three Canadian programmes at issue – Canada Account, the Export Development Corporation ("EDC"), and Investissement Québec ("IQ") – Brazil has identified the specific categories of support subject to its challenge. Numbered paragraph 1 of its request states that Brazil is challenging Canada Account "export credits, including financing, loan guarantees, or interest rate support . . . ". Numbered paragraph 5 states that Brazil is challenging EDC "export credits, including financing, loan guarantees, or interest rate support . . . ". Finally, numbered paragraph 7 states that Brazil is also challenging IQ "export credits and guarantees . . . , including loan guarantees, equity guarantees, residual value guarantees, and 'first loss deficiency guarantees' . . .".

21. Brazil's request specifically not only covers challenges to these measures *as such*, but states clearly that it is also a challenge to the measures *as applied* in, *e.g.*, the Air Wisconsin transaction. Finally, contrary to Canada's claim at paragraphs 42, 51 and 56, the very first paragraph of Brazil's request states that it is only concerned with these measures with respect to their role in regional

[9] WT/DS27/AB/R (Adopted 25 September 1997), para. 142.
[10] WT/DS22/AB/R (Adopted 20 March 1997), pg. 9.
[11] WT/DS98/AB/R (Adopted 14 December 1999), para. 120.

aircraft transactions. Brazil also notes that the title of the dispute is *Canada – Export Credits and Loan Guarantees for Regional Aircraft*.[12]

22. Canada's principal complaint appears to be that Brazil's claims are "extremely broad," "so broad as to defy definition", and that they "could potentially cover hundreds of clients and many thousands of transactions since 1995".[13] Canada appears to suggest that a claim must be narrow to satisfy Article 6.2 of the DSU.

23. Article 6.2 contains no such requirement. Brazil is entitled to raise broad claims that entire Canadian programmes are inconsistent with Canada's obligations under the SCM Agreement. Broadly-defined measures, such as the US tax treatment of foreign sales corporations, have often been the subject of WTO disputes, in circumstances where those measures would affect many more than the "hundreds" of clients affected by Brazil's claims against the Canada Account, EDC and IQ. It is a Member's prerogative to challenge any measure, no matter how broad, that it considers is inconsistent with another Member's WTO obligations.

24. In any event, Brazil notes that its claims are not nearly as broad as they could be. As noted above, Brazil's request clarifies that it is only concerned with the Canada Account, EDC and IQ with respect to their role in regional aircraft transactions. Moreover, it has limited those claims to particular forms of support provided by or through the Canada Account, EDC and IQ. Canada Account uses types of support not included in Brazil's claims, including export credits insurance, performance insurance, and political risk insurance.[14] EDC similarly provides various types of support not subject to Brazil's claims, such as accounts receivable insurance, bonding, and political risk insurance. IQ also extends support not included in Brazil's claims, such as suretyship[15] and exchange rate guarantees.[16] For these reasons, Brazil's request complies with the third requirement set forth in *Korea – Dairy*.

3. Requirement (iv)

25. As noted above, the Appellate Body stated in *Korea – Dairy* that the fourth requirement flowing from Article 6.2 of the DSU is the inclusion in a request for establishment of "a brief summary of the legal basis of the complaint sufficient to present the problem clearly".[17] The Appellate Body emphasized that as long as the legal basis is identified and presents the problem clearly, "Article 6.2 demands only a summary – and it may be a brief one – of the legal basis of the complaint".[18]

26. As discussed above, Brazil's request for establishment of the Panel includes three overarching claims, against support by or through the Canada Account, EDC and IQ for the Canadian regional

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[12] In any event, in *European Communities – Customs Classification of Certain Computer Equipment*, the Appellate Body noted that "Article 6.2 of the DSU does not explicitly require that the products to which the 'specific measures at issue' apply be identified." WT/DS62/AB/R-WT/DS67/AB/R-WT/DS68/AB/R (Adopted 22 June 1998), para. 67. While a particular aspect of the covered agreement at issue might require product specification, Canada makes no such assertion with respect to the SCM Agreement.

[13] Canada's Preliminary Submission, paras. 41, 51.

[14] SUMMARY REPORT TO TREASURY BOARD ON CANADA ACCOUNT OPERATIONS, FISCAL YEAR 1998/99, pg. 4 (Exhibit Bra-46).

[15] An Act respecting Investissement-Québec and Garantie Québec, Art. 30(1) (Exhibit Bra-18).

[16] Décret 572-2000, 9 mai 2000, concernant le programme du Fonds pour l'accroissement de l'investessement privé et la relance de l'emploi, Art. 11(d) (Exhibit Bra-19).

[17] WT/DS98/AB/R (Adopted 22 June 1998), para. 120.

[18] *Id*.

aircraft industry. Brazil also expressly states in numbered paragraphs 1, 5 and 7 that those measures are prohibited export subsidies, within the meaning of Articles 1 and 3 of the SCM Agreement.[19]

27. Brazil has done more than simple "identification of the treaty provisions claimed," however. To ensure that the problem is presented clearly, as required by the Appellate Body in *Korea – Dairy*, numbered paragraphs 1 through 7 include details, discussed above, of the specific categories of support involved.

4. Attendant Circumstances

28. Even had Brazil done nothing more than simply identify the treaty provisions involved, that would have been adequate to protect Canada from prejudice to its interests, or from harm to its due process rights. As the Appellate Body in *Korea – Dairy* has explained, the determination whether a defending party's Article 6.2 due process rights are harmed does not rest solely on the text of the request for the establishment of a panel.[20] Instead, as the Appellate Body in *Thailand – Anti Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland* notes, "The fundamental issue in assessing claims of prejudice is whether a defending party was *made aware of* the claims presented by the complaining party, sufficient to allow it to defend itself."[21] Thus, the "simple listing of the articles of the agreement or agreements involved may, in the light of [the] *attendant circumstances* [of the dispute], suffice to meet the standard of *clarity*" required by Article 6.2 that is necessary to protect a Member's due process rights.[22] In resolving whether a defending party's due process rights are harmed by "the simple listing of the articles of the agreement" involved in the dispute, a Panel may, among other things, "take into account . . . the actual course of the panel proceedings".[23]

29. The "attendant circumstances" in this case demonstrate that Canada's ability to defend itself has not been prejudiced. As noted in Brazil's first written submission, the Canada Account, EDC and IQ – the three programmes included in its request for establishment – were also challenged in an earlier dispute, *Canada – Measures Affecting the Export of Civilian Aircraft*. That dispute began in March 1997 with Brazil's request for consultations,[24] which was followed by a request for the establishment of a panel in July 1998.[25] In its initial phase, the dispute led to the release of a panel report in April 1999[26], and an Appellate Body report in August 1999.[27]

30. Brazil's challenge to Canada's implementation of the panel and Appellate Body reports led to the establishment of a panel in November 1999 under Article 21.5 of the DSU[28], a report by that panel in May 2000,[29] and a report by the Appellate Body in July 2000.[30] Consultations were requested by Brazil with respect to these very same programmes in January 2001.[31] As required by Article 4.2 of

[19] As noted above, numbered paragraphs 2-4 expand further upon the overarching claim regarding Canada Account included in numbered paragraph 1, which includes citation to Articles 1 and 3 of the SCM Agreement. Thus, it was not necessary for Brazil to cite to those same provisions yet again in numbered paragraphs 2 through 4.

[20] WT/DS98/AB/R (Adopted 22 June 1998), para. 127.

[21] WT/DS122/AB/R (12 March 2001) (Adopted 5 April 2001) para. 95 (emphasis supplied).

[22] WT/DS98/AB/R (Adopted 22 June 1998), para. 127 (emphasis supplied).

[23] WT/DS98/AB/R (Adopted 22 June 1998), para. 127.

[24] WT/DS70/1 (14 March 1997).

[25] WT/DS70/2 (13 July 1998).

[26] WT/DS70/R (14 April 1999) (Adopted 20 August 1999).

[27] WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999).

[28] WT/DS70/9 (23 November 1999).

[29] WT/DS70/RW (9 May 2000) (Adopted 4 August 2000).

[30] WT/DS70/AB/RW (21 July 2000) (Adopted 4 August 2000).

[31] WT/DS222/1 (25 January 2001).

the SCM Agreement, Canada was provided with a statement of available evidence illustrating the basis for Brazil's concerns.[32] Consultations were held in February 2001. During those consultations, specific and detailed questions were put to Canada by Brazil.[33] Brazil submitted an extremely specific letter to the Panel on 21 May 2001 in which it further detailed its claims against Canada. Brazil's First Written Submission, filed nine days later on 30 May 2001, two weeks after Canada's 16 May letter, also fully detailed all of Brazil's claims.

31. In addition, throughout this entire period, in an effort to resolve these disputes outside the auspices of WTO dispute settlement, Brazil and Canada, at the very highest diplomatic and political levels, have engaged in bilateral discussions on these very same programmes and issues.

32. Finally, and perhaps most importantly, despite Canada's purported confusion as to the subject matter of the current dispute and Brazil's request for the establishment of a panel, Canada's First Written Submission, filed 18 June 2001, contains a detailed and specific defence of its Canada Account, EDC and IQ regional aircraft financing programmes, both "as such," and "as applied" in the specific context of the Air Wisconsin and other transactions. This detailed defence thus responds to each of the claims Brazil raised in its request for the establishment of a panel to consider Canada's regional jet financing activities.

33. For these reasons, it is not credible for Canada to claim that Brazil's claims are not stated with sufficient clarity, or that its right to present a defence has been prejudiced. In the words of the Appellate Body in *Korea – Dairy*, the "attendant circumstances" suggest that Canada is very much aware of the issues and claims involved and, as such, has been and will continue to be able to vigorously defend itself.

34. Canada's 16 May 2001 request to Brazil for clarification of its claims, and Brazil's 21 May 2001 response to this request, does nothing to change these "attendant circumstances."

35. In paragraph 34 of its preliminary submission, Canada cites to the Appellate Body's statement in *Thailand – Anti-dumping Duties on Angles, Shapes and Sections of Iron or Non-alloy Steel and H-Beams from Poland* that "nothing in the DSU prevents a defending party from requesting further clarification on the claims raised in a panel request from the complaining party, even before the filing of the first written submission".[34] At paragraphs 58-59 of its preliminary submission, Canada states that it availed itself of this option with its 16 May request, but that in its 21 May response Brazil "refused to clarify its claims".[35]

36. Canada does not state precisely how its 16 May request changes the litany of "attendant circumstances" cited above illustrating its clear understanding of the measures and claims at issue in this dispute. Instead, Canada implicitly attempts to transform the Appellate Body's observation in *Thailand – Steel* that nothing in the DSU prevents a defending Member from submitting such a request into a requirement that a complaining Member provide a detailed response. While nothing in the DSU prevents a defending Member from requesting the clarification sought in Canada's 16 May letter, equally nothing in the DSU requires a complaining Member to provide a response sufficiently detailed to satisfy the defending Member. The Appellate Body's statement in *Thailand – Steel* does not, as Canada implies, impose a legal obligation on Brazil to unfold all of the details of its case in response to Canada's detailed 16 May request. Certainly, the Appellate Body did not intend to create

[32] *Id*.
[33] Exhibit Bra-1.
[34] WT/DS122/AB/R (12 March 2001) (Adopted 5 April 2001), para. 97.
[35] Canada did not, however, cite the Appellate Body Report in *Thailand – Steel* in its 16 May request.

a new "litigation technique"[36], encouraging Members to avail themselves of procedural counterclaims where none otherwise exist.

37. In any event, in addition to the attendant circumstances described above, Brazil notes that it provided considerable detail regarding its claims and evidence in its 21 May letter asking the Panel to exercise its authority under Article 13.1 of the DSU to request documentary evidence from Canada regarding the terms of Canada Account, EDC and IQ support for the Canadian regional aircraft industry. Absent a requirement in the DSU or the Panel's working procedures requiring even more detail, Brazil was thus entitled to present its case in its first written submission.

III. CONCLUSION

38. For the foregoing reasons, Brazil's request for establishment of this Panel is consistent with the terms of Articles 6.2 and 21.5 of the DSU. Brazil therefore requests that the Panel reject Canada's argument that certain of Brazil's claims are outside the jurisdiction of the Panel and should therefore not be considered on their merits.

[36] WT/DS122/AB/R (12 March 2001), para. 97.

ANNEX A-5

COMMUNICATION OF 25 JUNE 2001 FROM BRAZIL TO THE PANEL

(25 June 2001)

Secretary to Panel
Canada – Export Credits and Loan Guarantees for Regional Aircraft

25 June 2001

Please find attached correspondence between the Brazilian Mission in Geneva and Embraer, which is provided in response to the request of the Panel *Canada - Export Credits and Loan Guarantees for Regional Aircraft* (DS222), dated 20 June 2001, that the parties submit certain factual information relevant to this dispute.

Best regards,

Roberto Azevedo

(UNOFFICIAL TRANSLATION)

[ ]
[ ]

20 June 2001

[ ]

The WTO Panel examining the Canadian export credit programmes has asked Brazil in an urgent and confidential communication dated today, 20 June, for the full details of the terms and conditions of Embraer's offer of financing to Air Wisconsin. The deadline for the response expires on 25 June next, Monday.

Therefore we would appreciate receiving a response from you as soon as possible.

Sincerely,

Celso Amorim
Ambassador

(UNOFFICIAL TRANSLATION)

25 June 2001

Mr. Roberto Azevêdo
Counsellor
Permanent Mission of Brazil
17B, Ancienne Route
1218 Genève
Switzerland

Dear Counsellor,

Please refer to our letter dated 20 June 2001, describing the terms and conditions of EMBRAER's financing offer to Air Wisconsin ("AWC"), for the purchase of regional jets.

Firstly, we would like to inform you that our initial commercial offer covered [], as detailed below:

[]	[]
[] [] []	[]

Aircraft prices were established in accordance with the configuration specified by AWC. Likewise, delivery schedule conformed to AWC's request.

EMBRAER made two financing offers, neither of them involving any support from the Brazilian Government.

A. <u>The first offer</u>

EMBRAER committed itself to identifying and structuring the financing by means of credit lines obtained in the commercial financial market.

(1) For [], EMBRAER committed itself to providing:

- []
- []
- []

(2) For []

We were told by AWC that our offer was not competitive. [] We therefore improved the offer to take these and other points into account.

B. <u>The second offer</u>:

EMBRAER committed itself to identifying and structuring the financing by means of credit lines obtained in the commercial financial market.

(1) For []

We are at your disposal for any further details that may be necessary.

Sincerely,

[]
[]

ANNEX A-6

ORAL STATEMENT OF BRAZIL REGARDING JURISDICTIONAL ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

1. On 22 June, we responded to Canada's allegation that Brazil's request for establishment of this Panel was inconsistent with the terms of Article 6.2 and 21.5 of the DSU. The EC also provided its views on this issue in its 22 June third party submission.

2. I will not repeat here the views already expressed in Brazil's 22 June submission other than to note that Brazil's request for the establishment of a Panel in this case was simple and straightforward. Brazil stated clearly that this dispute involved export credits and guarantees for regional aircraft provided through three Canadian programmes – Canada Account, EDC and Investissement Québec. Brazil made clear that it challenged each of those programmes as prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement. These are the only articles of the covered agreements at issue in this dispute. Brazil also referred to offers or grants by Canada under these programmes that gave rise to Brazil's request.

3. Put simply, Brazil has asked the Panel to make yes or no determinations as to whether these three programmes – and specific transactions within those programmes – constitute prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement. Brazil also has asked that you make specific factual findings, which you are empowered to do by Article 11 of the DSU.

4. Obviously, as everyone is aware from the written submissions before the Panel and the entire history of the disputes involving regional aircraft, the issue of whether these programmes violate these articles raises many controversial arguments of law and fact. In addition, Canada may raise other provisions of the SCM as an affirmative defence for these programmes. The fact that the case may become complex, however, does not create a lack of clarity in Brazil's request for the establishment of a Panel.

5. Brazil also rejects any suggestion that the wording of its request in any way prejudiced Canada's or the third parties' ability to participate in the current dispute. Canada – which had, of course, the benefit of consultations with Brazil on the issues raised in this dispute in March of this year – has put forth a detailed and wide-reaching defence of its programmes. The EC, which also claimed its rights have been curtailed, has also submitted extensive comments on the legal issues it considers relevant to this dispute. These submissions reflect the customary standards of submissions made by both Canada and the EC in both the *Brazil* and *Canada* regional aircraft disputes and show no sign of confusion as to the issues at stake here. It simply is not credible to say that Canada and the EC have been deprived of due process by the alleged lack of adequate notice of Brazil's claims.

6. In Brazil's view, Canada's objection to the wording of Brazil's request for a Panel represents nothing more than a gambit to avoid a determination as to whether the challenged programmes are prohibited export subsidies within the meaning of articles 1 and 3. These objections, along with the EC's objections, should be rejected by the Panel.

ANNEX A-7

ORAL STATEMENT OF BRAZIL REGARDING SUBSTANTIVE ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

Mr. Chairman, Members of the Panel, Representatives of the WTO Secretariat, and Members of the Canadian Delegation:

1. Thank you for the opportunity to meet with you today. This morning, I will discuss Brazil's claims against Canadian support for its regional aircraft industry through three programmes: the Export Development Corporation ("EDC"), the Canada Account, and Investissement Québec ("IQ"). In Brazil's view, each programme is a prohibited export subsidy "as such," and each programme provides prohibited export subsidies "as applied." Before discussing these programmes, however, I would like to begin with some important background.

2. The event that triggered this process was the 10 January 2001 announcement by Canada's Industry Minister, Mr. Brian Tobin, that Canada would provide export credits to assist the Canadian manufacturer, Bombardier, in selling regional jet aircraft to Air Wisconsin, an airline in the United States. This transaction was the subject of your 20 June request for information from both parties.

3. Mr. Tobin admitted that the support Canada was offering was contrary to Canada's obligations under the Subsidies Agreement, but he justified the action as "matching" of an illegal offer that he said was made by the Brazilian manufacturer, Embraer, with assistance from the Government of Brazil.

4. There are three things wrong with Mr. Tobin's statement.

5. First, the Article 21.5 Panel in the earlier *Canada – Aircraft* dispute held that recourse to the "matching" provisions of the OECD Export Credit Arrangement does not bring an export credit practice into "conformity with" the "interest rates provisions" of the OECD Arrangement.[1] It does not, therefore, permit a Member to take advantage of the "safe haven" included in item (k) of the Illustrative List of Export Subsidies annexed to the Subsidies Agreement.

6. Second, even if conformity with the matching provisions of the Arrangement permitted recourse to the "safe haven" in item (k), Canada's action did not meet the requirements of those provisions. Article 29 of the OECD Arrangement requires Participants, such as Canada, intending to match credit terms and conditions allegedly offered by non-Participants, such as Brazil, to follow the procedures in Article 53. These procedures, in turn, require the Participant to "make every effort to verify" that the terms and conditions it is intending to match "are officially supported."

7. Canada made no effort to verify with the Government of Brazil whether the terms and conditions being offered by Embraer were officially supported. Indeed, when Mr. Tobin was asked at

[1] *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (Adopted as modified by the Appellate Body, 4 August 2000), paras. 5.120-5.140.

his press conference whether he had informed Brazil of Canada's action, he responded, "I just did."[2] Mr. Tobin was correct. Brazil first learned of Canada's claim that Brazil was offering support to Embraer from reports of his press conference.

8. Third, and most important, Embraer made its offers to Air Wisconsin without any support of any kind whatsoever from the Government of Brazil or from any entity controlled by the Government of Brazil. Embraer had no support from PROEX, the Brazilian subsidy programme that has been the subject of other disputes. It had no support from the BNDES, the Brazilian development bank that Canada has complained of in other contexts. Embraer's offers were for its own account and at its own risk. The terms of those offers are detailed in the 25 June response Brazil provided to the Panel's request for information regarding the Air Wisconsin transaction.

9. Although there was no official Brazilian support for the terms and conditions offered by Embraer, the company nevertheless found itself being underbid, not by its commercial competitor, Bombardier, but by the exchequer of the Government of Canada.

10. While the Air Wisconsin transaction was the event that convinced Brazil that further negotiations with Canada were unlikely to resolve this dispute, it was far from the only reason Brazil requested this Panel. Embraer finds itself competing with the Canadian Treasury through several Canadian programmes, including the Export Development Corporation ("EDC"), Canada Account, and Investissement Québec ("IQ"). In this statement, I will follow the organizational structure of Brazil's First Written Submission. First, I will discuss EDC, then Canada Account, and finally, Investissement Québec. In each instance, I will describe the evidence satisfying each of the three elements of a prohibited subsidies claim: financial contribution, benefit, and export contingency in law or in fact.

I. Export Development Corporation "As Such"

11. I will begin with the claim that support for the Canadian regional aircraft industry through the Export Development Corporation – EDC – constitutes prohibited export subsidies "as such."

12. It is undisputed that the reason for EDC's very existence is to "complement" the market.[3] The word "complement" is a euphemism for "*in addition to* what the market provides". Something "in addition to" what the market provides may be "better" or "worse" than what the market provides, but it is not the same. Clearly, however, the financial support EDC provides is not likely to be "worse" than what the market provides. The evidence I will discuss later in my statement demonstrates that, in "complementing" the market, EDC in fact provides "better" than what the market provides.

13. This is not unexpected. It would be pointless for a government to establish an organization to provide something worse than what the market provides. The organization would have no patrons if that were the case. They all would flock to the better terms of the market. But the patrons of EDC – Canadian exporters – do not flock to the market. Instead they flock to EDC, because what they find there is better than what they would find in the market. There is no other valid reason for them to utilize the services of EDC, and Canada has provided none.

14. Canadian exporters go to EDC for "financial contributions" that are included within Brazil's "as such" claim. Most, if not all of these, are delivered by EDC through its "market window." I will discuss these financial contributions overall, and then will review the specific example of loan

[2] Exhibit Bra-21, paras. 98-101.

[3] EXPORT DEVELOPMENT CORPORATION, *1995 Chairman and President's Message*, pg. 4 ("*EDC Message*") (Exhibit Bra-24).

guarantees. Next, I will review why the superior services EDC offers are themselves financial contributions within Brazil's "as such" claim. All of these financial contributions confer benefits "as such," are *de jure* export contingent, and are therefore prohibited.

A. Market Windows

15. Nearly all financial contributions by EDC's Corporate Account, whether in the form of loans or loan guarantees, are so-called "market window" operations. This issue was discussed at length in Brazil's First Written Submission. There is relatively little direct evidence of how exactly EDC's market window lending activities work, given Canada's reluctance to provide information.

16. Several points can be made, however, which demonstrate that whenever EDC operates through the "market window," it grants export subsidies "as such." As an agent of the Government of Canada, EDC borrows at Canada's sovereign rate, pays no income taxes, and is not expected to pay dividends. Despite this inherently low cost of funds – something no commercial institution enjoys – EDC does not consider itself constrained by the same OECD Export Credit Arrangement disciplines placed upon the government export credit agencies of the other Participants. As long as it does not extend support below "what the relevant borrower has recently paid in the market for similar terms and with similar security,"[4] EDC considers itself free to ignore the limitations placed on export credit agencies by the OECD Arrangement. Among other points, it is not clear how Canada defines the words "recently" and "similar". It claims to operate, instead, as a market-based institution in direct competition with private financial institutions and exporters, including exporters in developing countries.

17. EDC does not, in fact, operate as a market-based financial institution. A market-based financial institution, for example, would not limit its support to Canadian exporters, but EDC does exactly that. This behaviour is typical of a governmental export credit agency, not a private bank. A market-based financial institution's shareholders would demand that it support any transaction and any customer, regardless of nationality, provided it considered the transaction sufficiently profitable. EDC supports only Canadians, with the goal of obtaining "a competitive advantage for Canadian exporters, not just a level playing field."[5] To obtain this "competitive advantage," EDC retains the discretion and has the incentive to pass along the benefits of its extraordinarily low cost of funds to Canadian exporters.

18. The United States, at paragraph 5 of its third party submission, confirms Brazil's point that market window operations are largely free of market constraints. Such operations "are in a position to confer benefits by exceeding, if sometimes only in a small way, what purely market-based financial institutions can (or may be willing) to offer. Their ability to do so explains their existence, since *there would otherwise be no reason for market windows to exist* in parallel with private financial market actors, much less any logical reasons for governments to limit their market window activities to nationals."

19. EDC and its market window operations "as such" are inconsistent with Canada's obligations under the Subsidies Agreement. The sole reason for their existence, and their only logical use, is to provide what the market does not provide – support on terms better than its clientele, Canadian exporters and their customers, could otherwise obtain on the market.

20. Further, export credits in any form can also confer a benefit by reducing, if not eliminating, the need of the seller to lower its price to remain competitive. When

[4] Canadian First Written Submission, para. 67 (emphasis removed).

[5] Testimony of EDC President Mr. Ian Gillespie before the Standing Committee on Foreign Affairs and International Trade, 6 November 1997, pg. 15 (Exhibit Bra-26).

goods are sold on credit, the total cost to the buyer is a combination of the price of the goods and the cost of the credit. When governments provide financing at rates lower than otherwise would be available to the parties, they also permit the seller to keep the price of the goods higher than it otherwise could. In this way, export credits can be viewed as conferring a benefit on the seller of the goods in the form of price support.

B. Loan guarantees

21. A specific example of the kinds of financial services EDC offers is loan guarantees. Canada has acknowledged that loan guarantees are provided by the EDC to Canadian regional aircraft purchasers.[6] Loan guarantees are expressly mentioned in the first subparagraph of Article 1.1(a)(1) as "financial contributions" in the form of "potential direct transfers of funds or liabilities".

22. A financial contribution provides a "benefit," within the meaning of Article 1.1(b) of the Subsidies Agreement, if it accords "terms more favourable than those available to the recipient on the market."[7] By definition, EDC loan guarantees allow a recipient to obtain funds on terms more favourable than it otherwise could obtain on the market. In discussing a US Export-Import Bank loan guarantee, Canada acknowledged as much, stating that "[i]n such circumstances, the lending bank establishes financing terms *in the light of the risk of the US Government, not the borrower*."[8]

23. EDC, as an agent of the Government of Canada, provides credits at extremely favourable rates. It enjoys a credit rating of AAA from Standard & Poors and the Japan Credit Rating Agency, and Aa1 from Moody's.[9] Purchasers of Canadian regional aircraft do not enjoy similar standing. Even large international airlines, let alone smaller regional airlines, do not enjoy such standing. United Air Lines, for example, holds a Ba1 credit rating from Moody's, and a BB+ rating from Standard & Poors. An EDC loan guarantee would allow United to enjoy the benefits of EDC's AAA rating, which will certainly help it secure better financing terms than it could secure on its own. Thus, EDC guarantees provide benefits "as such."

24. In its defence, Canada asserts – at paragraph 84 of its First Written Submission – that EDC charges fees for its guarantees. But what fees? How much are they? How are they determined? What kind of guarantee does this fee buy? To establish its right to this defence, Canada at least must demonstrate that the fees EDC charges regional aircraft purchasers are commensurate with those charged by commercial guarantors with AAA credit ratings to regional aircraft purchasers wishing to enjoy the benefits of those guarantors' AAA ratings. Moreover, even if Canada could show that purchasers of regional aircraft enjoy the same credit rating as the Canadian government, the guarantee would still confer a benefit as long as "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."[10]

25. Finally, there can be no serious question that EDC loan guarantees are contingent upon or tied to export, within the meaning of Article 3.1(a) of the Subsidies Agreement. Section 10(1) of the Export Development Act states that EDC "was established . . . for the purposes of supporting and

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[6] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (Adopted as modified by the Appellate Body, 20 August 1999), paras. 6.99-6.100.

[7] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Adopted 20 August 1999), para. 158.

[8] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (Adopted as modified by the Appellate Body, 4 August 2000), Annex 1-2 (para. 36) (emphasis added).

[9] EXPORT DEVELOPMENT CORPORATION ANNUAL REPORT 2000, pg. 41 (Exhibit Bra-22).

[10] Subsidies Agreement, Article 14(c).

developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[11]

C. Services

26. Under the third subparagraph of Article 1.1(a)(1) of the Subsidies Agreement, financial contributions can take the form of "services other than general infrastructure." EDC provides various types of assistance to the Canadian regional aircraft industry and its purchasers. Its financing support and financing packages for Canadian regional aircraft purchasers, as well as the financing and loan guarantees that are part of that support and those packages, are examples.

27. Canada has acknowledged that EDC provides its financing support and financing packages on terms more favourable than a recipient could receive on the market. According to the EDC, it "*complements* the banks and other financial intermediaries," and absorbs risk for Canadian exporters "*beyond what is possible* by other financial intermediaries."[12] Additionally, "EDC's financing support gives Canadian exporters an *edge* when they bid on overseas projects,"[13] which – Canada has explained – refers to "the ability of EDC officials to assemble *better structured financial packages* . . . ."[14] All of these services – financial packages that are better structured, assistance that complements and goes beyond that provided by commercial banks, support that grants an edge – by definition offer something better than that available to Canadian exporters on the market. They therefore confer benefits.

28. The previous panel examining EDC support did <u>*not*</u> find, as Canada claims at paragraph 77 of its submission, that a determination of benefit "cannot be inferred or extrapolated from the generic statements of the EDC or its officials." A review of the paragraphs from the *Canada – Aircraft* report cited by Canada reveals no such principle. In any event, while Brazil's claim in the earlier case was that the statements I have just read suggested that EDC provides lower interest rates than are commercially available, its claims in this dispute are broader than that. These statements establish, at a minimum, that EDC – by its own admission – provides "services" that are better than what a recipient could get on the market.

29. With respect to export contingency, I refer again to Section 10(1) of the Export Development Act, which provides EDC's export mandate.[15]

30. Finally, Mr. Chairman, I would like also to note that the arguments I have just raised may equally be made to support an "as applied" claim.

II. EDC Corporate Account "As Applied"

31. In addition to its challenge against EDC "as such," Brazil also challenges EDC's application in several regional aircraft transactions. I will not, however, repeat the details of the individual transactions, discussed in paragraphs 43 and 59 of Brazil's First Written Submission.

32. The Panel will note Canada's statement at paragraph 64 of its First Written Submission that EDC has not participated in the Midway transaction described in Brazil's Submission. Similarly, at paragraph 65 of its Submission, Canada states that EDC did not provide loan guarantees for the Comair transaction described in Brazil's Submission. Brazil accepts the correction. We would note,

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[11] Exhibit Bra-17.
[12] *EDC Message*, pgs. 4, 2 (emphasis added) (Exhibit Bra-24).
[13] WT/DS70/R, para. 6.57 (*quoting* former EDC President Paul Labbé) (emphasis added).
[14] WT/DS70/R, para. 9.163 (emphasis added).
[15] Export Development Act, Section 10(1) (Exhibit Bra-17).

however, that the non-transparent nature of EDC's operations makes it difficult for outsiders to obtain information about its transactions. The degree of non-transparency that characterizes EDC's operations can be appreciated by the fact that most of the information Brazil cited in its First Submission about EDC's operations was from third country sources, not Canadian sources.

33. It is significant, however, that Canada has not denied Brazil's allegations regarding EDC support for the Kendell and ASA transactions, also described in paragraphs 43 and 59 of Brazil's First Submission. The evidence discussed in Brazil's Submission indicates that EDC provided financial contributions for these transactions in the form of direct or indirect transfers of funds or liabilities. EDC support for these transactions was for periods ranging from [ ] years, which are beyond the 10-year maximum term identified in the OECD Arrangement.

34. The interest rates on these particular transactions are not disclosed in any public source of which Brazil is aware. However, the Panel should note that, in another proceeding, Canada has admitted that the EDC Corporate Account has extended fixed interest-rate export credits at interest rates below the OECD Arrangement's minimum interest rate, the CIRR.[16] EDC has not identified the specific transactions, except to state that they occurred sometime after 1 January 1998.

35. These financial contributions confer a benefit. As the Appellate Body in *Brazil – Aircraft* stated, a net interest rate to a borrower below the relevant CIRR is "positive evidence" that the rate secures a "material advantage," under item (k) of Annex I to the Subsidies Agreement.[17] This reasoning applies equally to the other terms of the OECD Arrangement, including its maximum repayment terms. As discussed at paragraphs 51-54 of Brazil's First Submission, export support that confers a "material advantage" will always confer a benefit, since item (k) and the "material advantage" standard only become an issue when a subsidy, including a benefit, has already been demonstrated.

36. Brazil has identified particular instances in which the EDC Corporate Account has provided financial contributions beyond the 10-year maximum repayment term included in the OECD Arrangement and below the relevant CIRR identified by the Arrangement. In the Appellate Body's words, Brazil has provided "positive evidence" of EDC support on terms more favourable than those available to the recipient on the market. If it is Canada's position that its better-than-OECD terms are, nevertheless, "commercial," it is Canada's burden to prove it.

37. Finally, regarding export contingency, I refer again to Section 10(1) of the Export Development Act, which provides EDC's export mandate.

III. Canada Account "As Such"

38. I will now turn to Brazil's claims against Canada Account support for regional aircraft. It now appears that Canada Account is the vehicle by which Canada has provided the major part of its support to the Air Wisconsin transaction. This was not clear to us from Mr. Tobin's press conference which suggested that Canada's official support for that transaction came in a variety of guises. Moreover, at consultations, Canada's representatives were either unable or unwilling to say any more than that the support "probably" would be provided by Canada Account, rather than through EDC's Corporate Account.

39. The Article 21.5 Panel in the earlier *Canada – Aircraft* dispute determined that Canada had failed to implement the recommendations and rulings of the DSB with respect to Canada Account.

[16] WT/DS46/RW, Annex 1-4, pg. 82, Response of Canada to Question 4(a).

[17] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (Adopted 20 August 1999), para. 182.

Canada has notified no further action with regard to bringing Canada Account into compliance subsequent to adoption of the Article 21.5 Panel's ruling by the DSB. It should therefore be of no surprise, Mr. Chairman, that Canada Account continues to be inconsistent "as such" with Article 3.1(a) of the Subsidies Agreement. We have asked the Panel to make a finding confirming this fact.

40. Separately, Brazil makes the same arguments about the "as such" inconsistency with Article 3.1(a) of Canada Account loans and guarantees as it does with respect to EDC loans and guarantees. Canada Account provides financial contributions in the form of loans and guarantees,[18] which are direct or potential direct transfers of funds within the meaning of Article 1.1(a)(1) of the Subsidies Agreement.

41. Every time a loan guarantee is issued by the Canada Account, it enables the recipient to obtain funds on terms more favourable than it otherwise could obtain on the market. In Canada's own words, when describing a loan guarantee, "the lending bank establishes financing terms in the light of the risk of the [government guarantor], not the borrower."[19] In the case of the Canada Account, a guarantee would lead a lender to establish terms in light of the Government of Canada's AAA rating, not the lower rating of the aircraft purchaser. The recipient realizes a very real and significant benefit because of a Canada Account guarantee.

42. With respect to export contingency, paragraph 80 of Brazil's First Written Submission demonstrates that only export transactions are eligible for Canada Account support. The Panel in the earlier *Canada – Aircraft* dispute found that Canada Account was *de jure* contingent on export.[20] Canada has made no changes to Canada Account that would affect that finding.

43. We have demonstrated the three elements of a prohibited export subsidies claim. The Panel should therefore conclude that Canada Account loans and guarantees are prohibited export subsidies "as such."

IV. Canada Account "As Applied"

44. Brazil also challenges the way Canada Account is applied, which is illustrated by the Air Wisconsin transaction. The facts of Canada Account's participation in that transaction are described in Brazil's First Written Submission. Unfortunately, they were not provided by Canada to Brazil on 25 June 2001. In any event, through Canada Account, Canada is providing a financial contribution in the form of a loan (or the debt portion into a US leveraged lease) on terms that its Industry Minister described as follows:

> What we're doing here is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier.[21]

45. Canada does not contest that Canada Account support for the Air Wisconsin transaction confers a benefit, or that such support is contingent in law or in fact on export. Instead, it claims that its actions are justified under the "safe haven" included in the second paragraph of item (k) to the Illustrative List of Export Subsidies annexed to the Subsidies Agreement. Specifically, Canada claims

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[18] EDC SUMMARY REPORT TO TREASURY BOARD ON CANADA ACCOUNT OPERATIONS FISCAL YEAR 1998/1999, pg. 4 (Exhibit Bra-46). *See also* EDC website, "How We Work" (Exhibit Bra-16).

[19] WT/DS46/RW, Annex 1-2 (para. 36).

[20] WT/DS70/R, para. 9.230.

[21] Transcript of Press Conference of Industry Minister Brian Tobin, 10 January 2001, para. 20 (Exhibit Bra-21).

that it was "merely matching Brazil's offer in a manner consistent with the 'interest rates provisions' of the [OECD] Arrangement."[22]

46. The problem with this argument, as I said at the outset, is that there is no Brazilian offer for Canada to match. There is only an Embraer offer. The Arrangement permits matching only of officially supported credits, not privately offered credits. Further, even if official credits had been offered – and they were not – the Article 21.5 Panel in the earlier *Canada – Aircraft* dispute made clear that the matching provisions may not be used by WTO Members to justify a prohibited subsidy. Finally, even if the matching provisions were available, Canada failed to "make every effort to verify" that official support was involved in Embraer's offer to Air Wisconsin. It did not direct any inquiries to Brazil – something it is required to do, we believe, by Article 53 of the Arrangement.

B. Canada Offered Air Wisconsin More Favourable Terms

47. Moreover, even if matching allowed a Member to preserve its ability to use the "safe haven" in item (k) to shield support not conforming with the interest rates provisions of the OECD Arrangement, and even if Canada had satisfied the requirement to "make every effort to verify" that official support was involved, it did not match Embraer's offer. Rather, in making a "non-identical" match,[23] it seems clear that Canada offered Air Wisconsin terms more favourable than those offered by Embraer. Bombardier, after all, won the contract.

48. Mr. Chairman, here I intended to compare the terms of Embraer's offer to Air Wisconsin to the terms of the sale and financing provided to Air Wisconsin by Bombardier and Canada. Canada, however, failed to share with Brazil on 25 June 2001 the terms of the Air Wisconsin transaction and, as we already stated, Brazil is asking the Panel to draw the appropriate adverse inferences from Canada's failure to fulfil the Panel's instructions as well as its failure to comply with Article 18.1 of the DSU.

49. If there are any doubts, let us make absolutely clear that all information provided by Brazil is highly sensitive and confidential.

V. Investissement Québec "As Such"

50. I will now turn to Brazil's claims against Investissement Québec support for regional aircraft "as such." As Brazil noted in its First Written Submission,[24] Investissement Québec provides a range of support to companies that qualify as financial contributions. These include loan guarantees, first loss deficiency guarantees to equity investors, and "any other form of intervention provided for in . . . [Investissement Québec's] business plan."[25]

51. During consultations, Canada was either unable or unwilling to advise Brazil how Investissement Québec was providing support to Bombardier's Air Wisconsin transaction. In fact, Canada's representatives told us they were unprepared even to discuss Investissement Québec, a programme that was clearly identified in Brazil's request for consultations.

52. In its First Submission, Canada takes pains to state that Investissement Québec "has never provided residual value guarantees" for Bombardier aircraft sales.[26] However, Canada does not deny that Investissement Québec has provided significant support to Bombardier in general, and in the Air

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[22] Canadian first written submission, para. 48.
[23] *Id.*, para. 46 and note 36.
[24] Brazilian First Written Submission, paras. 84-86.
[25] An Act Respecting Investissement-Québec and Garantie-Québec, Art. 25 (Exhibit Bra-18).
[26] Canadian First Written Submission, footnote 80.

Wisconsin transaction in particular. Indeed, Canada admits that if Air Wisconsin chooses to structure the transaction [ ], ". . . [W]ith respect to [ ] aircraft, the Government of Québec is providing a guarantee [ ]."[27] This guarantee is provided under Article 28(1) of the IQ Act. In addition, Canada does not deny that, in 1996, Investissement Québec "created a five-year $450-million programme to provide loan guarantees to Bombardier's customers," and that the provincial cabinet recently approved "another $76 million" for this purpose.[28]

53. As Canada notes in its First Submission, "the provision of such guarantees by a government or public body constitutes [a direct or] potential direct transfer of funds or liabilities within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement and would therefore be a 'financial contribution.'"[29]

54. These guarantees also provide a benefit. As discussed above with respect to Canada Account, each time Investissement Québec issues a guarantee to a purchaser, this guarantee enables the recipient to borrow funds based upon the credit rating of the Government of Québec. This is because the credit rating of the Government of Québec is at least A+. This is invariably higher than the credit rating of virtually any commercial purchaser, particularly one buying regional aircraft. Guarantees issued by Investissement Québec thus confer a significant benefit because these guarantees allow firms buying Bombardier aircraft to borrow funds at a more favourable rate than would otherwise be available to them on the market

55. Like EDC, Canada again attempts to defend Investissement Québec by claiming that Investissement Québec charges a fee for its guarantees. Yet Canada again fails to describe the size of these fees, or even how they are assessed. As such, Canada bears the burden of proof to establish that these alleged fees affect the benefit that Investissement Québec guarantees provide to purchasing companies.

56. Canada also argues that IQ's support is not contingent upon export because it is available for sales within Canada outside Québec. Canada's view is both erroneous and subversive of the export subsidies disciplines of the Agreement.

57. Let me first explain why Canada's view is erroneous. Article XXIV:12 of GATT 1947 calls upon contracting parties to ensure that GATT's provisions are observed by regional and local governments within its territory. This requirement is now incorporated into the WTO by GATT 1994. Further, the *Understanding on the Interpretation of Article XXIV*, which is part of GATT 1994, provides that each WTO Member is responsible for the observance of all provisions of GATT 1994, "and shall take such reasonable measures as may be available to it to ensure such observance by regional and local governments and authorities within its territory." The *Understanding* then goes on to specify that if the "reasonable measures" taken are not sufficient to remove an offending measure, "The provisions relating to compensation and suspension of concessions or other obligations apply."

58. WTO Members are responsible for measures taken by their sub-central authorities. In this case, this means that for WTO purposes a measure taken by Québec is effectively a measure taken by Canada. The question, therefore, is: may Canada convert a subsidy, otherwise contingent upon export, into a non-export contingent subsidy by making part, but not all, of its territory eligible for sales of the subsidized product?

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[27] Canadian First Written Submission, footnote 37.

[28] "Ottawa backs Bombardier: Loan to US firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9).

[29] Canadian First Written Submission, para. 87.

59. Canada's designation of part of its territory – in this case, Québec – as ineligible for the subsidy has the necessary effect of increasing the incentive of producers to export and the likelihood that they will do so because all of their home territory is not available to them. Canada seems to imply that, because nine of its 10 provinces remain eligible markets for the subsidized goods, this is somehow close enough to 10 out of 10. But if a Member may make one province ineligible, why not two? Why not three? Why not nine?

60. Would Canada agree to apply its position to Brazil's PROEX subsidy if Brazil were to make part of its domestic territory eligible for interest rate support for regional aircraft? Would Canada be willing to do so if Brazil were to designate a small village in the Amazon that did not have an air strip as the eligible domestic territory?

61. If not, how is the line to be drawn? The WTO dispute settlement process is ill-equipped to decide how much domestic territory must be made eligible for the subsidy in order to do away with an export designation. There is admittedly a large difference between a small village and an entire country except for a single province or state, but how is the line to be drawn?

62. Clearly, it cannot be drawn in any acceptable manner, and this demonstrates how Canada's position is subversive of the subsidy disciplines of the WTO. If eligibility of part, but not all, of a Member's territory for a subsidy is enough to remove export contingency, many small, partial domestic eligibility designations are likely to follow rapidly. Brazil maintains, therefore, that IQ guarantees are in law or in fact contingent on exports.

VI. Investissement Québec "As Applied"

63. In addition to its challenge against Investissement Québec "as such," Brazil also challenges Investissement Québec's application in regional aircraft transactions supporting the sale of aircraft by Bombardier to Air Wisconsin.

64. As I have already noted, IQ spokesman Jean Cyr has indicated that Investissement Québec established a five-year, $450 million fund to provide guarantees to Bombardiers' customers. Mr. Cyr also reported that when Bombardier approached the Québec government seeking further support for its sale to Air Wisconsin, in December 2000, approximately $150 million of the $450 million fund remained unused. In response to Bombardier's specific request for support, the provincial cabinet approved an additional $76 million to support the sale to Air Wisconsin. The result was that $226 million was made available to support the export sale to Air Wisconsin.

65. Canada has not denied that Investissement Québec provides guarantees. At paragraph 87 of its First Written Submission, Canada notes that Brazil has only referred to loan guarantees and has confirmed that loan guarantees are financial contributions for purposes of Article 1.1(a)(1)(i) of the SCM Agreement.

66. Canada has also not denied that Investissement Québec provided subsidies to support the sale to Air Wisconsin. In fact, at footnote 37 of its First Written Submission, Canada notes that if the [], the Government of Québec is providing a guarantee [ ] of each aircraft." This is not the only example of specific application of Investissement Québec support for Bombardier's export sales. A further example is discussed at paragraph 90 of Brazil's First Written Submission.

67. Canada has taken the position that the guarantees provided by Québec through Investissement Québec to support Bombardier's sales are not subsidies, on the basis that they confer no benefit, and are not export subsidies, because they are not made contingent on export. I will deal with each point separately.

68. With respect to benefit, as I have already noted, the guarantees provided by Investissement Québec are based on the credit rating of the Province of Québec, not the credit rating of the borrower. There is no question that these loan guarantees will provide a benefit.

69. Moreover, with respect to the Air Wisconsin transaction, Canada stated, at paragraph 46 of its First Written Submission, that its financing offer to Air Wisconsin was made to match what it assumed to be Brazil-supported below-market financing for Embraer aircraft. As Canada confirmed, in footnote 37, the Québec government support was included in this transaction. Therefore, it is clear that the Government of Québec was also providing support intended to match the assumed Brazil-supported, below-market financing. As I have already noted, there was no officially supported below market financing to match. The result is that the subsidy provided by Canada Account conferred a benefit and, likewise, the subsidy provided by Québec through Investissement Québec conferred a benefit.

70. With respect to export contingency, I have already addressed this issue generally. Investissement Québec guarantees are export subsidies because they are contingent on export. With respect to the Air Wisconsin transaction, the contingency on export is even more apparent. Mr. Cyr confirmed that the provincial cabinet only decided to approve additional funds after Bombardier "came to us and said they were negotiating this big deal with Air Wisconsin that would require" more than the remaining $150 million. Air Wisconsin is, of course, a US airline. Every Canadian regional jet manufactured in Québec, in fact, has been exported not only out of Québec, but out of Canada. The Government of Québec also knew that Bombardier was competing with Embraer for the contract and believed that Bombardier was competing with Brazil-supported, below-market financing. The additional funds requested by Bombardier were approved by the provincial government so that Bombardier could win the Air Wisconsin contract. Therefore, the subsidy provided to support Bombardier's sale to Air Wisconsin was clearly tied to exports and, therefore, was contingent on exports.

71. Finally, and still, with regard to IQ, Mr. Chairman, I have to admit I am a little bit confused. A moment ago I mentioned the statement made by IQ spokesman Mr. Cyr that, in 1996 the provincial investment fund created a five-year $450 million programme to provide loan guarantees to Bombardier's customers. Mr. Cyr then stated that, about $300 million of that fund had been used when Bombardier approached IQ on 20 December 2000 and "said they were negotiating this big deal with Air Wisconsin that would require" more than the remaining $150 million. This statement is contained in Brazil's Exhibit 9. Mr. Cyr's statement seems to be confirmed by a publication of 17 June 1995 stating that Brit Air, a purchaser of regional jet aircraft from Bombardier, obtained the assistance of Bombardier, of a French bank, and of the Société de Développement Industriel du Québec (SDI) to complete the financing.[30] The relevant text of the announcement, which we are distributing as an exhibit, reads in French: "Chaque Regional Jet coûte 20 million de dollars, une fois aménagé à l'intérieur. Compte tenu de son prix, Brit Air a obtenu l'assistance de la société Bombardier, celle d'une banque française, de même que celle de la Société de développement industriel du Québec (SDI) pour compléter le financement."

72. Yet, at paragraph 117 of Canada's Second Written Submission of 4 December 1998 in *Canada - Aircraft*, Canada stated that *none* of the guarantees or financing activities under the "export development" eligibility criterion of SDI (which became IQ in 1998) was related to the civil aircraft sector.[31] On the basis of that statement, the Panel in *Canada - Aircraft*, at paragraph 9.275, found that, "Brazil has failed to adduce any evidence of IQ assistance to the Canadian regional aircraft sector. Accordingly, there is no basis for a *prima facie* case that IQ assistance has been provided to

[30] Exhibit Bra-52.
[31] *Id.*

the regional aircraft industry."[32] Mr. Chairman, these statements seem contradictory to us. Brazil would appreciate it if Canada could clarify this apparent contradiction and inform the Panel whether IQ has ever, in fact, been used to assist the Canadian regional aircraft industry, both prior to 4 December 1998, and, of course, after that date.

VII. Conclusion

73. Mr. Chairman, for all of these reasons, Brazil requests the Panel to conclude that EDC, Canada Account, and IQ are, "as such" and "as applied," prohibited export subsidies. We will do our best to answer any questions you might have.

[32] *Id.*

ANNEX A-8

RESPONSE OF BRAZIL TO ORAL STATEMENT OF CANADA REGARDING JURISDICTIONAL ISSUES AT THE FIRST MEETING OF THE PANEL

(28 June 2001)

1. Brazil noted at the 27 June 2001 meeting of the Panel that it would like to address some issues made by Canada in its Oral Statement on Jurisdictional Issues.

2. Canada claims that three "inconsistencies" between Brazil's First Written Submission and its 22 June 2001 response to Canada's 18 June 2001 Preliminary Submission regarding the Panel's Jurisdiction have left Canada confused about the scope of Brazil's claims. A review of those three instances reveals that no such inconsistencies exist.

3. Before reviewing these three alleged inconsistencies between two of Brazil's submissions, however, Brazil notes that these inconsistencies do not implicate the "specificity" requirement of Article 6.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). Article 6.2 speaks only to the specificity of Brazil's request for establishment of the Panel. Much as Brazil cannot, as Canada states, use its subsequent submissions to "cure" deficiencies in its request for establishment,[1] nor can Canada use those subsequent submissions to create deficiencies.

4. In its specific allegations, Canada first, at paragraph 22 of its oral statement on jurisdiction, points to an alleged inconsistency between paragraph 78 of Brazil's First Written Submission, and paragraph 24 of Brazil's 22 June response. Paragraph 78 of Brazil's First Written Submission states that "Canada Account offers . . . export credits insurance, financing services, performance insurance, and political risk insurance," and notes that those four categories of support constitute "financial contributions" under Article 1.1(a)(1) of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). This is a factually accurate statement, and does not state that all of those forms of "financial contributions" are subject to Brazil's claims with respect to Canada Account.

5. In contrast, paragraph 24 of Brazil's 22 June response identifies which of those specific forms of "financial contributions" are not the focus of its claims. As stated in its request for establishment, Brazil's claims against Canada Account are limited to "financing, loan guarantees, or interest rate support" for the regional aircraft industry.

6. Second, at paragraph 23 of its oral statement on jurisdiction, Canada points to an alleged inconsistency between paragraph 40 of Brazil's First Written Submission, and paragraph 24 of Brazil's 22 June response. Paragraph 40 of Brazil's First Written Submission states that "EDC offers 'a wide range of financial services,'" including "credit insurance, financing services, bonding services, political risk insurance and equity." It also states that all of those activities constitute "financial contributions" under Article 1.1(a)(1) of the SCM Agreement. Again, this is a factually accurate statement, and does not state that all of those forms of "financial contributions" are subject to Brazil's claims with respect to EDC.

[1] Oral Statement of Canada on Jurisdictional Issues, 27 June 2001, paras. 15, 18, 21, 22.

7. In contrast, paragraph 24 of Brazil's 22 June response identifies which of those specific forms of "financial contributions" are not the focus of its claims. As stated in its request for establishment, Brazil's claims against EDC are limited to "financing, loan guarantees, or interest rate support" for the regional aircraft industry.

8. Third, at paragraph 24 of its oral statement on jurisdiction, Canada points to an alleged inconsistency between paragraph 92 of Brazil's First Written Submission, and paragraph 24 of Brazil's 22 June response. Paragraph 92 of Brazil's First Written Submission states that IQ provides loans, guarantees ("suretyship") and "'any other form of intervention provided for in its business plan.'" Paragraph 92 also states that all of these types of support constitute "financial contributions" under Article 1.1(a)(1) of the SCM Agreement. This is a factually accurate statement, and does not state that all forms of IQ loan or surety support are the subject of Brazil's claims regarding IQ.

9. In contrast, paragraph 24 of Brazil's 22 June response identifies those "financial contributions" that are not the focus of its claims. As stated in its request for establishment, Brazil's claims against IQ are limited to "loan guarantees, equity guarantees, residual value guarantees, and 'first loss deficiency guarantees'" for the regional aircraft industry.

10. Brazil does not consider the terms "guarantee" and "suretyship" necessarily to be synonymous in the field of export credits. As noted, Brazil's claim is limited to the various forms of guarantees listed in the request for establishment. To the extent that "suretyship" is another term for these guarantees, Brazil's statement at paragraph 24 of its 22 June response that it is not challenging "suretyship" may have been misplaced. Brazil's intent was to illustrate a type of guarantee not covered by its claims ("exchange rate guarantees").

11. Canada's main complaint is that Brazil's request for establishment is too broad. In its oral statement regarding jurisdiction, for example, Canada complained about the "broadly-worded nature of Brazil's Panel request."[2] This complaint is misplaced. Nothing in Article 6.2 of the DSU requires that Brazil's claims be narrow. Brazil was entitled, in its request for establishment of this Panel, to bring comprehensive claims against EDC, Canada Account and IQ. Brazil is entitled to maintain those claims throughout the duration of these proceedings. Brazil is also entitled to narrow those claims if the facts, as they are developed, dictate that it should do so.[3]

12. Indeed, as noted in paragraph 32 of its Statement for the First Meeting of the Panel, Brazil accepted, in good faith, Canada's correction that EDC was not involved in the Comair and Midway transactions, and narrowed its claim accordingly. Additionally, Canada's observation regarding the EC's Third Party Submission and the implications of the use of the "catch-all clause 'including, but not limited to'" is inapposite.[4] Brazil has neither asserted any right to expand, nor has it in fact expanded, its claims beyond the specific forms of EDC, Canada Account and IQ export credits listed in its request for establishment.

13. Moreover, the breadth of Brazil's claims is driven by the lack of information available about EDC, Canada Account and IQ. Canada has not notified any of these measures under Article 25 of the SCM Agreement.[5] Canada also refused to discuss the terms of its support for the Canadian regional

[2] Oral Statement of Canada on Jurisdictional Issues, 27 June 2001, para. 34.

[3] For example, as noted in paragraph 32 of its Statement for the First Meeting of the Panel, Brazil accepts Canada's correction that EDC was not involved in the Comair and Midway transactions. That is information that could have been, but was not, furnished to Brazil during consultations. Regardless, now that it has been brought to Brazil's attention, Brazil has narrowed its claim accordingly.

[4] Oral Statement of Canada on Jurisdictional Issues, 27 June 2001, para. 30.

[5] The Panel in *Canada – Measures Affecting the Export of Civilian Aircraft* recognized the evidentiary difficulties facing a claimant "especially where details of the alleged subsidy has [sic] not been notified under

aircraft industry *via* EDC, Canada Account and IQ during consultations with Brazil on 21 February 2001. Nor did Canada provide oral or written responses to the list of questions put to it by Brazil during consultations.[6] Canada's actions were contrary to the Appellate Body's requirement that parties be "fully forthcoming" and freely disclose facts relating to claims, "in consultations as well as in the more formal setting of panel proceedings."[7] Canada cannot decline to notify its measures, refuse to be responsive in consultations about those measures, and then object that Brazil's claims regarding those measures are so "vague and broadly-worded" as to prejudice Canada's ability to defend itself. Were that acceptable, a defending Member would deliberately fail to be "fully forthcoming," in the knowledge that doing so would facilitate a challenge to jurisdiction based upon the complaining Member's failure to observe the requirements of Article 6.2 of the DSU.

14. Brazil's request for establishment of this Panel satisfies the requirements of Article 6.2, as spelled out clearly by the Appellate Body in *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*.[8] It is in writing. It indicates that consultations were held. It identifies the measures at issue as specific types of export credits provided by three Canadian programs – EDC, Canada Account and IQ. Finally, it provides a brief summary of the legal basis for Brazil's claim, *i.e.*, that these three programmes, and specific transactions thereunder, constitute prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement. For these reasons, Brazil asks that the Panel reject Canada's claim that certain of Brazil's claims are not within this Panel's jurisdiction.

Article 25 of the SCM Agreement . . ." WT/DS70/R (Adopted as modified by the Appellate Body, 20 August 1999), para. 9.53.

[6] Exhibit Bra-1.

[7] *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R (19 December 1997) (Adopted 16 January 1998), para. 94.

[8] WT/DS98/AB/R (Adopted 14 December 1998), para. 120.

ANNEX A-9

RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST MEETING OF THE PANEL

(6 July 2001)

Questions to the Parties – 29 June 2001

THESE QUESTIONS ARE INTENDED TO FACILITATE THE WORK OF THE PANEL, AND DO NOT IN ANY WAY PREJUDGE THE PANEL'S FINDINGS ON THE MATTER BEFORE IT. NOR DO THEY PREJUDGE ANY RULINGS THAT MAY BE MADE BY THE PANEL REGARDING ITS JURISDICTION.

PLEASE NOTE THAT THE PANEL USES THE TERMS "AS SUCH" AND "AS APPLIED" BECAUSE THEY ARE USED BY THE PARTIES. THE PANEL'S USE OF THESE TERMS IS IN NO WAY INDICATIVE OF THE PANEL'S VIEWS ON THE IDENTITY OF THE SPECIFIC MEASURES AT ISSUE.

Questions for both Parties

1. What, if any, is the precedential effect of the findings of the *Canada – Aircraft* (DS70) Panel on this Panel's consideration of Brazil's claims regarding the Canada Account and EDC programmes as such? What, if any, is the precedential effect of the findings of the *Canada – Aircraft* (DS70) Panel on the matching provisions of the OECD Arrangement under item (k) of the Illustrative List of the SCM Agreement.

Panel reports do not have the effect of a legal precedent. Thus, the Panel in this case is fully entitled to consider Brazil's claims regarding the Canada Account and EDC programmes "as such." The Panel's jurisdiction and competence to review those programmes as such and make the appropriate findings are not, and could not be, affected by the fact that the same programmes were challenged as such in a previous case.

The Panel is entitled to, and in the view of Brazil should, consider the findings of the DS70 Panel with respect to Canada Account and EDC. The Panel may, of course, disagree with some of the findings in DS70. It may, on the other hand, determine the findings and the factual and legal conclusions made by the DS70 Panel useful for its analysis of Brazil's claims in these proceedings.

Similarly, with respect to the matching provisions of the OECD Arrangement under item (k), the Panel may, but does not necessarily have to agree with, the DS70 Panel's conclusions. In Brazil's view, while the Panel could, of course, disagree with some of the findings in DS70 on the matching provisions of the OECD Arrangement, it will likely find those findings useful for its analysis of Brazil's arguments that seeking recourse to the matching provisions of the Arrangement is not "conformity with" the "interest rate provisions" for the purpose of the second paragraph of item (k).

For a further discussion of issues relevant to this question, please see the response to Question 2 below.

2. Does this Panel have jurisdiction to review Brazil's claims regarding the Canada Account and EDC programmes as such? In particular, is the principle of *res judicata*, or a similar principle, applicable in this case, so as to preclude the Panel's consideration of issues previously ruled on by a Panel?

The Panel does have jurisdiction to review Brazil's claims regarding Canada Account and EDC as such. Neither the principle of *res judicata* nor any similar principle that might be applicable in this case precludes this Panel's consideration of issues that may have been previously ruled upon by another WTO panel. This is the case, even though the programmes – on the books – may not have changed since they were last reviewed by a WTO panel, for the following reasons.

In the DS70 proceedings the Panel did not rule that EDC was consistent with the SCM Agreement. It ruled that "Brazil has failed to demonstrate that the EDC programme as such *mandates* the grant of subsidies" and, for that reason, the Panel "may not make any findings on the EDC programme *per se*."[1] The Panel in DS70 thus found that the evidence adduced by Brazil was insufficient. The Panel, in other words, did not find that EDC was discretionary; rather, it found that Brazil had not proved that it was mandatory.

In this case, in addition to the evidence previously presented, Brazil has presented new evidence and new arguments on the basis of that new evidence. The DS70 Panel did not have that evidence and those new arguments before it. This Panel is therefore not prevented from taking a fresh look at the EDC programme and may, after considering the new evidence and arguments offered by Brazil, come to a different conclusion.

Similarly, the DS70 Panel did not rule that Canada Account as such was consistent with the SCM Agreement. It found that Brazil had failed to make a *prima facie* case and, as a result, the Panel could not "make any findings on the Canada Account programme *per se*."[2] With respect to Canada Account, Brazil has now presented additional information and evidence that presents a *prima facie* case.

Moreover, the DS70 Panel requested Canada to provide it with specific information regarding EDC transactions. Canada refused to comply with the request. Had Canada complied, the Panel would have possessed additional evidence regarding EDC's Canada Account and Corporate Account activities. Brazil asked the Panel to draw adverse inferences, which it declined to do.[3] The Appellate Body found that, while the Panel had the legal authority to draw adverse inferences, it did not err in law or abuse its discretionary authority in declining to do so.[4] The Appellate Body went further, however, and stated that if the Appellate Body "had been deciding the issue that confronted the Panel, we might well have concluded that the facts of record did warrant the [adverse] inference."[5] The Appellate Body further emphasized that by its finding it did "not intend to suggest that Brazil is precluded from pursuing another dispute settlement complaint against Canada, under the provisions of the *SCM Agreement* and the DSU, concerning the consistency of certain of the EDC's financing

[1] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (Adopted as modified by the Appellate Body 20 August 1999), para. 9.129 (emphasis in original).

[2] *Id*., para. 9.213.

[3] *Id*., para. 9.181-182.

[4] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R (Adopted 20 August 1999), paras. 203-205.

[5] *Id*., para. 205.

measures with the provisions of the *SCM Agreement*."[6] Brazil, in this case, is following the advice of the Appellate Body.

The new information and evidence Brazil has provided in this case allows it to make a *prima facie* case that not only certain of the Canada Account and EDC financing measures are inconsistent with the provisions of the SCM Agreement, but that the *modus operandi* of the programme as such is also inconsistent with the Agreement. The new evidence relates not only to specific transactions. It also relates to the *raison d'etre* of EDC in both its Canada Account and Corporate Account activities. That evidence shows that the very existence of these programmes – and, therefore, the programmes as such – is to provide export subsidies.

The new evidence is not limited to the Air Wisconsin transaction, although that transaction is a good example of the way the challenged programmes operate and of the interaction between EDC (Corporate Account) and EDC (Canada Account).[7] Canada's defences with respect to the Air Wisconsin transaction can be summarized as follows. When official government financing is provided, Canada "matches" such financing offered by other governments. When there is no official government financing, Canada operates through the market window and offers financing on terms available in the commercial marketplace. This is the way EDC operates the Canada Account and the Corporate Account. These operations are, in other words, the programmes "as such." Brazil challenges the programmes as such because the very way in which they are designed to operate is inconsistent with the SCM Agreement. A more detailed discussion of this argument is contained in Brazil's response to Question 28.

Further, by operating through the market window and by providing financing on terms that Canada alleges are available in the commercial marketplace – another function inherent in the challenged programmes – these programmes also fail to comply with the SCM Arrangement, and constitute a prohibited subsidy. Canada has failed to show that the programmes provide financing on terms available in the commercial marketplace when they allegedly operate through the market window. Quite the contrary, Brazil has shown that when the programmes ostensibly operate through the market window, the terms of the financing provided are more favourable than those to be found on the market. For a more detailed discussion, Brazil refers the Panel to paragraphs 28-39 of its First Written Submission and paragraphs 15-20 of its Oral Statement at the first meeting of the Panel.

In sum, the new evidence put forward by Brazil in this case, while indisputably showing that the programmes are inconsistent with the SCM Agreement "as applied," also shows that providing prohibited subsidies is inherent in the way the programmes are designed to operate and, therefore, that they are inconsistent with the SCM Agreement "as such."

Questions for Canada – Numbers 3-24

Questions for Brazil

25. Please identify the specific measures in respect of which Brazil is requesting the Panel to make findings. In particular, is Brazil requesting findings (1) on the Canada Account, EDC and IQ programmes as such, (2) on the Canada Account, EDC and IQ programmes as applied (on the basis of evidence regarding specific transactions), (3) on the specific Canada Account, EDC

[6] *Id*., para. 206.

[7] In this regard, Brazil recalls that Minister Tobin himself was not clear on whether EDC would handle the Air Wisconsin transaction under the Canada Account or the Corporate Account, and that the news release that accompanied his press conference described both, without specifying which would apply. Exhibit Bra-3.

and IQ transactions identified in its first submission, or (4) on some combination of (1), (2) and (3)?

Brazil is requesting findings by the Panel on points (1), (2), and (3). Brazil is requesting that the Panel find the Canada Account, EDC and IQ programmes as such inconsistent with Canada's obligations under the SCM Agreement. Brazil is also requesting that the Panel find the Canada Account, EDC and IQ programmes inconsistent with Canada's obligations under the SCM Agreement as applied on the basis of evidence regarding specific transactions. Finally, Brazil is requesting that the Panel find the specific Canada Account, EDC and IQ transactions identified in its First Written Submission as breaching Canada's obligations under the SCM Agreement.

26. What is the distinction between a claim concerning (1) a measure "as such" and (2) a measure "as applied"? What is the relevance of individual transactions in addressing claims concerning (1) a measure "as such" and (2) a measure "as applied"?

A measure "as such" is inconsistent with a Member's obligations when it calls for action by the executive authority that is inconsistent with a Member's WTO obligations. A measure is inconsistent "as applied" when its application is inconsistent with the WTO obligations of a Member.[8] Individual transactions may serve to illustrate and prove that a measure is inconsistent "as such" because it envisions that the transactions in question be carried out in a manner inconsistent with the WTO. Individual transactions may also serve to illustrate and prove that a measure is inconsistent "as applied" because, even if it does not require that the transactions in question be carried out in a manner inconsistent with a Member's WTO obligations, it is applied in an inconsistent manner.

In this case, Brazil challenges EDC, Canada Account and IQ both "as such" and "as applied." Brazil has shown that individual transactions breach Canada's obligations under the SCM Agreement. This should be sufficient for a finding that the programmes are inconsistent "as applied."

In addition, however, individual transactions serve to illustrate that it is inherent in the design and the *modus operandi* of the three challenged Canadian programmes to operate in a manner that is inconsistent with the SCM Agreement.

27. Please identify the specific findings or recommendations, if any, that Brazil is requesting on the issue of whether or not Canada has implemented the findings and recommendations resulting from Brazil's recourse to Article 21.5 in the DS70 proceeding?

Brazil is requesting a ruling by the Panel that, *as a matter of fact*, Canada has done nothing since the adoption of the Report in the Article 21.5 DS70 proceedings to bring Canada Account in compliance with the SCM Agreement.

The Panel in the DS70 proceedings found that "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constitutes export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement"[9] and concluded that "Canada shall withdraw [those] subsidies … within 90 days."[10] The Appellate Body affirmed.[11] The Article 21.5 Panel found that "the measures taken by Canada to comply with the DSB recommendation on the application of

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[8] *See United States – Denial of Most-Favoured Nation Treatment as to Non-Rubber Footwear from Brazil*, BISD 39S/128 (19 June 1992), para. 6.13, *citing United States – Taxes on Petroleum and Certain Imported Substances ("Superfund Taxes")* BISD 34S/136 (17 June 1987) *and EEC – Regulation on Imports of Parts and Components*, BISD 37S/132 (16 May 1990).

[9] WT/DS70/R, para. 10.1(b).

[10] *Id*., para. 10.4.

[11] WT/DS70/AB/R, paras. 220 and 221.

the Canada Account programme are not sufficient to ensure that future Canada Account transactions in the Canadian regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement,* and are therefore not sufficient to ensure that such Canada Account transactions will not be prohibited export subsidies."[12] Canada did not appeal that finding.

Brazil is not asking this Panel to review the findings of the DS70 Article 21.5 Panel or to uphold or confirm the findings of that Panel. Similarly, Brazil is not asking this Panel to draw conclusions as to what Canada should have done. Brazil simply is requesting a factual finding that, since the adoption of the DS70 Article 21.5 Report, Canada has not made any changes in Canada Account. It is Brazil's understanding that Canada does not dispute this as a matter of fact. Indeed, in response to a question from the Panel during the second day of the Panel's first meeting, Canada confirmed that it had made no changes in the statutes and regulations that constitute the legal basis of EDC (Corporate Account or Canada Account).

28. The United States argues that the distinction between discretionary and mandatory legislation has been described by a WTO Panel as a "well established" principle (para. 2 of the US oral statement). Does Brazil consider that the distinction between discretionary and mandatory legislation is "well established"? If so, is the distinction applicable in this case?

Brazil agrees with the United States that the distinction between discretionary ("as applied") and mandatory ("as such") legislation is an established principle of GATT and WTO jurisprudence. Brazil does not believe, however, that the principle in those precise terms is applicable in this case to the Canadian programmes challenged by Brazil.

The recent Report in *United States – Measures Treating Export Restraints as Subsidies* noted that "a number of Panels, in disputes concerning the consistency of a legislation, have *not* considered the mandatory/discretionary question in the abstract and as a necessary threshold issue. Rather, the Panels in those cases first resolved any controversy as to the requirements of the GATT/WTO obligations at issue, and only then considered *in light of those findings* whether the defending party had demonstrated adequately that it had sufficient discretion to conform with those rules. That is, the mandatory/discretionary distinction was applied *in a given substantive context.*"[13]

The "substantive context" of EDC is that of an Export Credit Agency ("ECA"). ECAs exist to subsidize exports. This is their purpose. Their "subsidies … enable the country's industries to capture part of an expanded world market for their goods – or, at least, … keep [them] from being excluded from it."[14] They "provide or […] insure credits to insolvent markets; … *[they] absorb the risks that 'no banker in his right mind' is willing to assume.*"[15]

The history of item (k) and the Arrangement make this clear. The Arrangement was concluded in 1978, after many long years of negotiation.[16] Meanwhile, the Tokyo Round negotiations were concluded only a year later, in 1979. The Tokyo Round included a Subsidies Code that, *inter alia*, obligated parties not to use export subsidies in a manner inconsistent with the Code (Article 8.2) and not to grant export subsidies on products other than certain primary products (Article 9.1).

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[12] *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (Adopted as modified by the Appellate Body 4 August 2000), para. 6.1.

[13] *United States – Measures Treating Export Restraints as Subsidies*, WT/DS194/R (29 June 2001) (Not yet adopted), para. 8.11 (emphasis in original) (footnotes omitted).

[14] JOHN E. RAY, MANAGING OFFICIAL EXPORT CREDITS – THE QUEST FOR A GLOBAL REGIME, Institute for International Economics (1995), pg. 13 (Exhibit Bra-54)

[15] *Id*. (emphasis added).

[16] *Id.,* pgs. 40-44. *See also* GARY CLYDE HUFBAUER AND JOANNA SHELTON ERB, SUBSIDIES IN INTERNATIONAL TRADE 68-69 (Washington, D.C., Institute for International Economics 1984) (Exhibit Bra-55).

The participants in the recently-concluded OECD Arrangement, most if not all of which were potential signatories to the plurilateral Tokyo Round Code, were faced with the fact that actions by their respective ECAs permitted by the newly-negotiated Arrangement would, nonetheless, be inconsistent with their obligations under the Code. In the words of Gary Hufbauer, one of the Tokyo Round negotiators, "many countries were unwilling to condemn as export subsidies those practices condoned in the OECD."[17] The solution to this problem was the second paragraph of item (k) – the safe haven clause for practices that conform to the interest rate provisions of the Arrangement.[18] ECA operations indeed are export subsidies, the negotiators recognized, but they will not be considered as an export subsidy so long as they comply with the interest rate provisions of the Arrangement.

Thus, item (k) allows ECAs to perform their normal function and, at the same time, meet GATT, and now WTO, requirements. Whenever an ECA operates within the scope of item (k), it is not considered to be providing an export subsidy. If the operation of an ECA, however, is not covered by the exceptions in item (k), it is providing a prohibited subsidy "as such" because providing export subsidies, as the Tokyo Round negotiators realized, is inherent in the very existence and functioning of an ECA. That, to repeat, is why they created item (k).

In that context, the argument that Canada's programmes are not mandatory and therefore are not inconsistent with the SCM Agreement must fail. EDC, whether through its Canada Account or its Corporate Account operations, constitutes a measure that is designed "as such" to provide export subsidies. EDC financing is a financial contribution that confers a benefit and is contingent upon exportation. Canada, of course, has available the potential affirmative defense of item (k). But the presence of this potential defense does not affect the nature of the programmes "as such."

Further, even if the programmes may not *always* require a violation of the SCM Agreement (e.g., when matching or operating through the market window, assuming the Panel agrees with Canada on those issues) they would still be inconsistent with the SCM Agreement. As the Panel in *United States – Measures Treating Export Restraints as Subsidies* concluded, if a measure requires a violation of a WTO obligation, "whether in some or in all cases," the measure "as such" is inconsistent.[19] Referring to the Appellate Body report in *Argentina – Footwear*, the Panel concluded that "a measure is inconsistent with WTO rules if that measure mandates action inconsistent with WTO rules in particular circumstances, even if in other circumstances the action might not be inconsistent with WTO rules."[20] Canada's programmes require providing prohibited export subsidies except in the circumstances where those subsidies might fall within the "safe haven" of item (k).

29. With regard to Brazil's claims regarding Canada Account, EDC and IQ as such, does Brazil consider that Canada Account, EDC and IQ as such require the provision of prohibited export subsidies?

Yes. As discussed in detail in Brazil's response to Question 28, EDC's Corporate and Canada Accounts as such require the provision of prohibited export subsidies because they are established and operate as export credit agencies that have as the *raison d'etre* of their existence the provision of export subsidies. As explained in Brazil's response to Question 28, ECAs provide prohibited export subsidies unless they comply with the disciplines imposed by the GATT, and later the WTO, on their functioning and operations through the rules of the OECD Arrangement and also fall within the scope of the exceptions provided in item (k). Brazil has shown that the programmes in question provide financial contributions that confer a benefit and are contingent upon export. Therefore, Canada must

[17] Hufbauer and Erb, *supra*, pg. 70 (Exhibit Bra-55).
[18] Ray, *supra,* pgs. 36-38 (Exhibit Bra-54).
[19] WT/DS194/R, para. 8.77.
[20] *Id*., para. 8.78.

meet the burden of proof of its affirmative defense and show that the programmes fall within the scope of the exception of item (k). Canada has failed to do so.

A classic example of a prohibited subsidy – and a good illustration of Brazil's argument – are export loan guarantees. Export loan guarantees provided by government financing institutions or ECAs always confer a benefit because they confer the government's superior credit rating to a private party. If the government's credit rating were not superior, there would be little point to the guarantee. As Brazil pointed out in its Oral Statement, EDC loan guarantees allow the recipient to obtain funds on terms more favourable than it otherwise could obtain on the market.[21]

IQ is somewhat different in the sense that it covers various activities, including investment promotion in Quebec, supporting business development in Quebec, etc. One aspect of the programme, however, calls for the provision of loan and equity guarantees. With respect to that particular component of IQ, the programme operates as an ECA, and, for the reasons described above, is inconsistent with the SCM Agreement "as such."

30. Please respond to paragraph 52 of Canada's 18 June 2001 preliminary submission regarding the jurisdiction of the Panel.

In paragraph 52 of its 18 June 2001 preliminary submission, Canada states that Brazil challenges not only EDC financial contributions defined in Article 1.1(a)(1)(i) but also an unlimited range of financial services defined in Article 1.1(a)(1)(iii) of the SCM Agreement. Canada asserts that, because Brazil did not specify in its claim which services it challenged and did not identify the specific provisions of Article 1 on which it relied, Brazil's claim is contrary to Article 6.2 DSU. Canada's argument should be rejected.

Brazil notes that Article 1 of the SCM Agreement does not deal with Canada's *obligations* under the SCM Agreement; rather, it simply *defines* the term "subsidy." A subsidy as defined in Article 1 is prohibited by Article 3 if it is conditioned on export. The *obligation* is in Article 3.

In *Korea – Dairy*, the Appellate Body found that the EC's request for the establishment of a Panel was adequate even though it simply listed articles that contained multiple obligations.[22] For example, in that case the EC simply cited Article XIX, and, as the Appellate Body noted, "Article XIX of the GATT 1994 has three sections and a total of five paragraphs, each of which has at least one distinct obligation."[23] Nonetheless, the Appellate Body found that Korea was not prejudiced by this broad request.[24]

Here, Brazil's request for the establishment of the Panel is far more specific than the EC request that the Appellate Body found adequate in *Korea – Dairy*. Brazil's request specified that certain "export credits" were "export subsidies" within the meaning of Articles 1 and 3. Of necessity, this description included paragraph 1 of Article 1, since that paragraph defines subsidies. It also, of necessity, included subparagraphs (a) and (b) of paragraph 1, because those sub-paragraphs define the constituent elements of a subsidy. It also, of necessity, included sub-sub-paragraph (1) of sub-paragraph (a) because that defines "financial contribution" and the term "export credits" could only fit in that sub-sub-paragraph. Certainly Canada cannot plausibly suggest that it believed sub-sub-paragraph (2) of sub-paragraph (a), dealing with income and price support in the sense of Article XVI

[21] For a more detailed discussion, Brazil refers the Panel to paras. 21-25 of its Oral Statement of 27 June 2001.

[22] *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R (Adopted 12 January 2000), para. 129.

[23] *Id*.

[24] *Id*., para. 131.

of GATT 1994, had anything to do with "export credits." In this regard, Brazil would note that it is Canada, not Brazil, that is a Participant on the *OECD Arrangement on Guidelines for Officially Supported Export Credits*. Presumably, therefore, Canada knows what the term "export credits" means.

Similarly, and although this argument was not raised by Canada or the Third Parties, Brazil notes that the reference to "export subsidies" within the meaning of Article 3 of necessity encompassed both paragraphs of that Article – there are only two, and the second consists of a single sentence with no subparagraphs. Of necessity it encompassed only sub-paragraph (a) of paragraph 1 as that is the subparagraph dealing with export subsidies. The only other subparagraph, (b), concerns a preference for the use of domestic over imported goods, and is not related in any way to "export," or "export credits," or "export subsidies."

The fact that Brazil did not specify in its claim which financial services it challenges does not violate Article 6.2 DSU. In its request for establishment, Brazil's *claim* is that the three Canadian programmes at issue are prohibited under Article 3 of the SCM Agreement. Under Article 1, the precise way in which the Canadian programmes grant financial contributions, and the way in which they confer benefits, are *arguments* in support of that claim. In *European Communities – Bananas*, the Appellate Body emphasized that "Article 6.2 of the DSU requires that the *claims*, and not the *arguments*" be sufficiently specified in a request for establishment.[25] It is noteworthy that there cannot be a "violation" of Article 1 of the SCM Agreement, which simply identifies various types of financial contributions and defines a subsidy. Brazil cannot claim that Canada has violated Article 1; it can only claim that Canada has violated Article 3.

Moreover, Brazil again notes that Canada's complaint is, for the most part, with what it believes is the breadth of Brazil's claim with respect to EDC financial services. Members are entitled to maintain broad claims, however. After confirming that Brazil has met the threshold requirements of Article 6.2 of the DSU – that its request for establishment be in writing, indicate that consultations were held, identify the measures at issue, and provide a brief summary of the legal basis for its claim[26] – the ultimate question for the Panel is whether Canada's right to defend itself has been prejudiced. That question can only be answered on a case-by-case basis, based on the "attendant circumstances."[27]

The "attendant circumstances" demonstrate that Canada's own actions have driven the breadth of Brazil's claims.[28] As the Appellate Body noted in *Thai – Steel*, a defending Member's own conduct is relevant to the precision of a complaining Member's request for establishment.[29] Canada has not notified any of the challenged measures under Article 25 of the SCM Agreement. Moreover, it refused to discuss the terms of its support for the Canadian regional aircraft industry *via* EDC, Canada Account and IQ during consultations with Brazil on 21 February 2001. It also refused to provide oral or written responses to the list of questions put to it by Brazil during consultations. Canada's actions are contrary to the Appellate Body's requirement that parties be "fully forthcoming" and freely disclose facts relating to claims, "in consultations as well as in the more formal setting of Panel proceedings."[30] Canada cannot decline to notify its measures, refuse to be responsive in

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[25] *European Communities – Regime for the Implementation, Sale and Distribution of Bananas*, WT/DS27/AB/R (Adopted 25 September 1997), para. 143.

[26] WT/DS98/AB/R, para. 120.

[27] *Id*., paras. 127, 124.

[28] In paragraphs 29-33 of its 22 June 2001 reply to Canada's preliminary submission regarding the Panel's jurisdiction, Brazil identified additional "attendant circumstances" demonstrating that Canada's ability to defend itself in these proceedings has not been prejudiced.

[29] *Thailand – Anti-dumping Duties on Angles, Shapes and Sections of Iron or Non-alloy Steel and H-beams from Poland*, WT/DS122/AB/R (Adopted 5 April 2001), para. 91.

[30] *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*, WT/DS50/AB/R (Adopted 16 January 1998), para. 94.

consultations about those measures, and then object that Brazil's claims regarding those measures are so broad as to prejudice Canada's ability to defend itself.

31. Please respond to paragraph 14 of Canada's oral statement of 27 June 2001 (on substance).

In paragraph 14 of its oral statement, Canada raises three possibilities with respect to the terms of Embraer's offers to Air Wisconsin. Brazil will address them one by one.

First, the Government of Brazil did not and has not made a commitment to Embraer, formal or informal, to provide support in connection with the Air Wisconsin offer. Embraer could not have made the offers to Air Wisconsin with the "understanding" that the government would provide the necessary support; there can be no such understanding before the completion of the approval process, much less before the initiation of the process. Brazil cannot say whether Embraer made the offers "in the expectation" that the government would provide support. Even assuming that was the case, however, the authorities in charge of reviewing and approving applications of support would not have based their decision on Embraer's expectations, but on the criteria specified in the appropriate legal instruments.

Second, Brazil is not in a position to discuss the accuracy of the representations made by Air Wisconsin officials to [] the Canadian officials. In the absence of an opportunity to present witnesses for cross examination, the Panel's task will be to evaluate the evidence as it is. Brazil would think that its own statement would have stronger evidentiary value than that [].

Third, Canada finds it incredible that Embraer would have been able to arrange commercial financing and find sources of commercial credit that would provide terms such as those offered to Air Wisconsin. Canada's views on this matter are irrelevant. Canada is essentially questioning Embraer's commercial and marketing strategy, which Canada is neither entitled nor qualified to do.

Companies have been known to offer aggressive pricing to win market share. The Air Wisconsin transaction []. One can speculate more what Embraer intended to do, but the fact remains that Brazil offered no government support to Embraer for the Air Wisconsin transaction.

32. According to the unofficial translation of Embraer's financing offer to Air Wisconsin, "EMBRAER made two financing offers, neither of them involving any support from the Brazilian Government". Does this assertion mean that, in respect of the proposed transaction with Air Wisconsin, there was no intention on the part of Embraer to seek/arrange any support from the Brazilian Government at any time, or to seek/arrange any support under Brazil's PROEX programme?

The same unofficial translation also states, for both offers, that "EMBRAER committed itself to identifying and structuring the financing by means of credit lines obtained in the commercial financial market". Please explain how the English phrase "<u>commercial</u> financial market" may be derived from the Portuguese phrase "mercado financeiro".

As discussed in the response to Question 31, Brazil cannot say what the intention on the part of Embraer was when the offers to Air Wisconsin were made. In response to Question 33, Brazil has provided [] as Exhibit Bra-56. [].

Brazil can definitively state that the Brazilian Government did not provide support to Embraer or Air Wisconsin for this transaction. Support from the Brazilian Government would have required Embraer to go through the requisite process, and would have been approved only if the criteria

specified in the applicable legal instruments had been met. No request was made to initiate that process.

Brazil would note that Embraer extended two offers to Air Wisconsin. After Embraer made its first offer, it was told that the offer was not competitive. Embraer then improved the offer (including the doubling of its first loss deficiency guarantee). Apparently, even Embraer's improved offer was not sufficient to compete with the offer made by Bombardier and Canada.

As to the translation, there was a mistake. The proper translation of the Portuguese phrase "mercado financeiro" in English is "financial market."

33. Was Embraer's second offer to Air Wisconsin made in writing? If so, please provide a copy of that second offer.

Brazil has provided as Exhibit Bra-56 [].[31]

34. Does Brazil consider that Canada's offer to Air Wisconsin was more favourable than the second EMBRAER offer to Air Wisconsin? If so, please explain precisely why.

Yes, Brazil believes that Canada's offer to Air Wisconsin was more favourable than the second Embraer offer. The offers were clearly not identical, and Air Wisconsin just as clearly accepted Bombardier's offer with Canadian government support. It would not have done so had it not found the offer more favourable. Neither Brazil nor, in Brazil's view, the Panel, is able to establish the contrary.

Finding itself with no basis for its claim that Brazil supported Embraer in the Air Wisconsin transaction, Canada falls back on a "no-benefit, no-subsidy" theory. It notes the statement by an Air Wisconsin official to the effect that the offers in their entirety were equivalent. Brazil makes two observations about that statement. First, it appears that Air Wisconsin was contractually obligated to make this statement, if we are reading Canada's Air Wisconsin submission correctly. No one would seriously expect Air Wisconsin to make a conflicting statement – such as, perhaps, that Canada's offer was better – in the face of this contractual obligation. Second, the Air Wisconsin spokesman evaluated the offers in their "entirety." Embraer's offer, however, contained a special element unrelated to financing.[32] Thus, when Canada subsidized to "match" Embraer's offer (assuming Embraer's offer was actually matched) it did not simply match the financing. It used a subsidy to meet Embraer's offer in its "entirety" which went beyond financing.

35. Please comment on paragraph 75 of Canada's first written submission, including the contents of Exhibit CDA-12.

Canada asserted in paragraph 75 of its First Written Submission that "standard commercially available financing terms for regional aircraft sales range from 10 to 18 years." Canada has not elaborated on which commercial entities offer those terms, but Brazil recalls that in *Canada – Aircraft* Canada referred specifically to two large banks, Bank of America and Citibank, as providing financing in the field.[33]

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[31] Pursuant to Article 16 of the Panel's Working Procedures, Brazil requests that the confidential, bracketed information included in the above paragraph be excluded from the version of this submission attached to the Panel Report. As already noted, Brazil requests similar treatment for Exhibit Bra-56 itself.

[32] *See* Brazil's letter to the Panel of 25 June 2001, containing the description of the terms of the Embraer offer to Air Wisconsin, last paragraph.

[33] WT/DS70/R, para. 6.31.

Brazil therefore conducted a Westlaw search of the financing activities of these two banks with respect to aircraft. That search shows no indication that the market supports terms of financing in the range alleged by Canada.[34]

Practically all financing done by these banks was for sales of large aircraft. In the predominant majority of those cases, the term of financing does not exceed 12 years – the upper limit specified in the OECD Arrangement for large aircraft. The only two exceptions, where the term of financing exceeded 12 years, are a credit to FedEx to be used in aircraft leasing (Bank of America) and an 18 year financing to LanChile for the purchase of Airbus (Citibank with several major European banks).

Further, contrary to Canada's implied suggestion that Citibank and Bank of America were among those that financed Bombardier transactions, the search showed no such financing. The only mention of Bombardier concerns a E66 million contribution by Citibank toward a credit facility for Bombardier to refinance existing debt and for general corporate purposes.

The search found financing for only one regional jet transaction in which the term was specified. This was for lease sale of two ERJ-145s to LOT Polish Airlines financed for a period of 10 years.

36. Please respond to the arguments advanced by Canada, the European Communities and the United States (both in their written submissions and oral statements) to the effect that matching is in conformity with the "interest rates provisions" of the OECD Arrangement.

Recourse to the matching provisions of the OECD Arrangement does not constitute "conformity with" the "interest rate provisions" of the OECD Arrangement. The ordinary meaning of item (k), in its context, along with the object and purpose of the SCM Agreement, supports this interpretation.

In Brazil's view, however, a threshold question is whether Canada even adhered to the requirements of the Arrangement's matching provisions in the Air Wisconsin transaction. If the Panel finds that Canada failed to observe those requirements, it need not answer what would become a moot question – whether matching allows a Member to maintain "conformity with" the interest rate provisions of the OECD Arrangement.

It is Canada's burden to show that it did adhere to the requirements of the Arrangement's matching provisions in the Air Wisconsin transaction. Brazil notes that the deadline for Canada to provide factual evidence demonstrating its adherence to the Arrangement's matching provisions, as set by paragraph 14 of the Panel's Working Procedures, has passed. In any event, Canada failed to meet the requirements of the matching provisions in several ways.

First, although Article 53(a) of the Arrangement states that an Arrangement Participant "shall make every effort to verify" that terms not conforming with the Arrangement are "officially supported," it did not do so here. Making "every effort to verify" whether support from the Brazilian government was the source of the non-conforming terms certainly should have included actually asking the Brazilian government. Canada did not do so. Had it done so, it would have learned that Embraer's offer to Air Wisconsin involved no support from the Brazilian government. The offer provided to Air Wisconsin by Embraer was Embraer's alone.

Second, Canada has not demonstrated that it informed its fellow Participants of the nature and outcome of the verification efforts called for by Article 53(a). Nor has it provided evidence

[34] Exhibit Bra-57.

demonstrating that it notified other Arrangement Participants of the terms and conditions of its support for the Air Wisconsin transaction, as it is required to do under Articles 53(b) and 47(a) of the Arrangement.

Third, in a footnote to its first submission, Canada states that it was justified in extending "non-identical matching" to Air Wisconsin.[35] As is evident from Canada's 26 June response to the Panel's 20 June request for information regarding the terms of its Air Wisconsin offer, Canada in fact extended terms and conditions that were not identical to those offered by Embraer. Non-identical matching is permitted, under Article 52 of the Arrangement, with respect to non-notified, non-conforming terms and conditions offered by *another Participant*. This option is not available, however, under Article 53, which regulates matching of non-conforming terms and conditions offered by a *non-participant*.

Fourth, if Canada is allowed to use non-identical matching, it bears the very significant burden of demonstrating that the "non-identical" offer it extended to Air Wisconsin was *equal to, and not more favourable than*, Embraer's offer. Canada cannot meet this burden. As discussed in Brazil's response to Question 34, Canada's offer was in fact more favourable to Air Wisconsin than Embraer's offer.

Therefore, in the Air Wisconsin transaction, Canada did not adhere to the Arrangement's matching requirements. Further, Canada in fact offered Air Wisconsin considerably more favourable terms than did Embraer. However, even if the Panel disagrees with Brazil on those points, Canada is not entitled to the "safe haven" of item (k), because recourse to matching does not allow Canada to maintain "conformity with" the "interest rate provisions" of the OECD Arrangement.

The Article 21.5 Panel in *Canada – Aircraft* agreed. It focused on the meaning of the phrase "in conformity with," and correctly concluded that matching – even if done according to the procedures included in the matching provisions of the Arrangement – brings the matching offer out of, and not into, conformity with the interest rates provisions of the Arrangement.[36]

The Panel distinguished between "exceptions" in the Arrangement – for which specific and narrowly-tailored variations are spelled out – and "derogations" – for which no specific or tailored allowances for variation are demarcated.[37] According to the Panel, considering a derogation (such as matching a non-conforming offer) to be "in conformity with" the interest rates provisions of the Arrangement would undermine the entire purpose of the Arrangement, which is to impose discipline upon the use of officially-supported export credits.[38]

Moreover, the Article 21.5 Panel in *Canada – Aircraft* noted that any interpretation of item (k) must "provide clarity and certainty concerning what the (SCM Agreement) rules are and how to comply with them."[39] The interpretation advocated by Canada, the EC and the US – an interpretation that preserves recourse to the "safe haven" of item (k) when matching is employed – would remove all clarity and certainty about the application of the SCM Agreement for the approximately 120 WTO Members who do not happen to be participants in the OECD Arrangement. While the Arrangement includes a slew of notification provisions making instances of matching by Participants transparent to other Participants, non-participants are left completely in the dark.

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[35] Canadian First Written Submission, 18 June 2001, footnote 36.
[36] WT/DS70/RW, para. 5.125.
[37] *Id.*, paras. 5.121-5.125.
[38] *Id.*, para. 5.120. *See also* OECD Arrangement (1998), Introduction ("Purpose and Application") (Exhibit Bra-42).
[39] WT/DS70/RW, para. 5.133.

Under the Arrangement's rules, a Participant wishing to initiate a non-conforming offer or match another Participant's non-conforming offer is required to observe strict notification and waiting period requirements, both *vis-à-vis* all Participants and the specific Participant who made the initial non-conforming offer.[40] When it comes to matching, Participants therefore have significant information about what any other Participant intends to do, based on the following rules:

- A Participant must notify all other Participants if it wishes to initiate a non-conforming offer.[41] The initiating Participant must then respect certain waiting periods before going ahead with its non-conforming offer.

- A Participant intending to identically match another Participant's notified non-conforming offer, the matching Participant may proceed after observing a waiting period. But if the match is non-identical, the matching Participant must notify all Participants and respect additional waiting periods.[42]

- If a Participant intends to identically match another Participant's non-notified, non-conforming offer, it must give notice to the latter and observe certain waiting periods. But if the match is non-identical, the matching Participant must also notify all Participants and respect additional waiting periods.[43]

When non-participants are involved, however, the picture changes. If a Participant intends to match a non-participant's non-conforming offer, it need only notify other Participants and respect certain waiting periods. The non-participant receives no notice of the Participant's intent to match, or of the match itself.

The rather obvious differential treatment of Participants and non-participants concerned the Article 21.5 Panel in *Canada – Aircraft*.[44] Canada, the EC and the US all recognize this problem, although each offers a different solution.[45] This lack of agreement – even among those WTO Members who are also Participants in the Arrangement – illustrates the extent to which permitting recourse to matching would undermine "clarity and certainty concerning what the (SCM Agreement) rules are and how to comply with them."[46]

In addition, the various interpretations of how "matching" applies, offered by Canada, the EC and the US, raise serious questions of conformity with the most-favoured-nation requirements of Article I of GATT 1994. The inequitable notification requirements that would be imported into the SCM Agreement under the interpretation urged by Canada, the EC and the US would constitute a rule or formality in connection with exportation, and would accord an advantage, favour, privilege or immunity to some but not all Members. Such an interpretation is not to be favoured.

Canada's view that non-participants would be freed from the notification requirements of the Arrangement's matching provisions, and therefore granted a competitive advantage over Participants,[47] does not cure the Article I violation. Whether Participants or instead non-participants would benefit more from the importation of the OECD Arrangement's matching rules into the SCM

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[40] OECD Arrangement (1998), Articles 47(a), 50, 52.
[41] OECD Arrangement (1998), Article 47(a).
[42] OECD Arrangement (1998), Article 50.
[43] OECD Arrangement (1998), Article 52.
[44] WT/DS70/RW, para. 5.132.
[45] Canadian First Written Submission, footnote 46; Oral Statement of Canada, 27 June 2001, para. 32; EC Third Party Submission, 22 June 2001, para. 70; US Third Party Submission, 22 June 2001, para. 16.
[46] WT/DS70/RW, para. 5.133.
[47] Oral Statement of Canada, paras. 38-40.

Agreement is irrelevant; any interpretation of item (k) that would require more favourable treatment for some WTO Members would ensure a violation of Article I of GATT 1994.

Moreover, Canada's suggestion that the absence of an obligation to provide notifications somehow compensates for the fact that non-participants do not themselves receive the Participants' notifications is inapposite. Such "counterbalancing" of less favourable treatment in one area with allegedly more favourable treatment in another does not cure an Article I violation, as discussed by the Panel in *United States – Section 337 of the Tariff Act of 1930* in the context of Article III:4.[48]

As long as Canada's view of the acceptability of "non-identical" matching prevails[49], it is disingenuous for Canada, the EC and the US to argue that permitting Members to match and retain entitlement to the safe haven in Item (k) will create an incentive not to make non-conforming offers.[50] As Brazil has demonstrated in the context of the Air Wisconsin transaction, "non-identical matching" is not really matching at all. An allowance for non-identical matching is nothing more than a license to counter with a *more favourable* offer, and ultimately leads to a "race to the bottom." The reality of non-identical matching and the downward spiral it creates is precisely what the Article 21.5 Panel in *Canada – Aircraft* meant when it expressed concern that permitting matching "would directly undercut real disciplines on official support for export credits,"[51] and would raise the question why the rules included in Item (k) or the OECD Arrangement were necessary at all.

For all of these reasons, complying with the matching provisions of the OECD Arrangement should not permit prohibited export subsidies to take recourse to the "safe haven" of item (k).

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[48] L/6439, BISD 36S/345, para. 5.14 ("The Panel rejected any notion of balancing more favourable treatment of some imported products against less favourable treatment of other imported products. If this notion were accepted, it would entitle a contracting party to derogate from the no less favourable treatment obligation in one case, or indeed in respect of one contracting party, on the ground that it accords more favourable treatment in some other case, or to another contracting party.").

[49] Canadian First Written Submission, paras. 18, 46 (note 36).

[50] Canadian First Written Submission, para. 59; EC Third Party Submission, para. 66; US Third Party Submission, para. 13.

[51] WT/DS70/RW, para. 5.125.

ANNEX A-10

SECOND WRITTEN SUBMISSION OF BRAZIL

(13 July 2001)

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I. INTRODUCTION

1. This submission is Brazil's second written submission in this proceeding, containing Brazil's further arguments as to why direct financing, loan guarantees and interest rate support provided by Canada through the Export Development Corporation's ("EDC") Corporate and Canada Accounts, and Investissement Québec ("IQ"), constitute prohibited export subsidies within the meaning of Articles 1 and 3 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). This second submission supplements the arguments made in Brazil's first written submission, its statements to the Panel meeting on 27-28 June 2001, and its 6 July 2001 responses to the Panel's questions.

2. As a threshold matter, before addressing the substantive arguments regarding the nature of the challenged measures, Brazil has provided in Section II below additional responses to Canada's arguments regarding jurisdictional issues. Brazil submits that it is perfectly clear what Canadian measures and what provisions of the SCM Agreement are at issue in this dispute, and that any issues regarding the factual nature or legal construction of those measures are the precise *substantive* issues that this Panel was established to address. In addition, Brazil explains that the fact that there were previous proceedings before a different panel examining some aspects of some of the challenged measures is no bar to this Panel's examination of the substantive issues before it.

3. In Section III, Brazil responds to arguments raised by Canada and the Third Parties regarding Brazil's claim that EDC support for the Canadian regional aircraft industry through its Corporate and Canada Accounts constitute prohibited export subsidies. Brazil submits that Canada's attempts to describe EDC's Corporate and Canada Accounts as "discretionary" rather than "mandatory" measures are unsuccessful. Those measures are therefore subject to challenge "as such." Brazil also challenges the application of the Corporate and Canada Accounts in particular transactions, and addresses the documentary evidence provided by Canada in response to specific questions from the Panel regarding those transactions. That evidence demonstrates that EDC's Corporate and Canada Accounts constitute prohibited export subsidies "as applied."

4. In Section IV, Brazil addresses Canada's arguments regarding Brazil's claim that Canada Account and IQ support for the Air Wisconsin transaction constitute prohibited export subsidies. Canada has failed to establish that its offer to Air Wisconsin was "in conformity with" the "interest rates provisions" of the *OECD Arrangement on Guidelines for Officially Supported Export Credits* ("OECD Arrangement"). That offer is therefore not entitled to the so-called "safe haven" of item (k) to the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement.

5. Furthermore, Canada's alternative defence that its offer did not provide a "benefit" to Air Wisconsin because it merely matched market terms offered by Embraer also fails. First, Canada has not explained how EDC's vehicle for "official support," the Canada Account, can act outside the constraints of the "interest rates provisions" of the OECD Arrangement and still not constitute a prohibited export subsidy under the SCM Agreement. Second, Canada has not demonstrated that the terms of Embraer's offer to Air Wisconsin constitute the "market." Third, Canada has overlooked the benefit conferred upon *Bombardier* by a financial contribution extended to Air Wisconsin.

6. Section V responds to Canada's arguments that IQ support for the Canadian regional aircraft industry does not constitute prohibited export subsidies either "as such" or "as applied." Brazil addresses the relevance of various Québec Government decrees submitted by Canada in response to the Panel's questions, as well as information regarding guarantees provided by IQ in particular regional aircraft transactions. Given Canada's failure to provide much of the information specifically requested by the Panel, Brazil requests that the Panel adopt adverse inferences, and presume that the information, if produced, would demonstrate that IQ guarantees constitute export subsidies.

7. To the extent that Canada's 6 July 2001 responses to the Panel's questions have not been addressed elsewhere in this submission, Brazil provides brief comments in Section VI. Brazil notes, however, that due to logistical difficulties faced by Canada, the exhibits to Canada's responses to the Panel's questions were not received by the responsible Brazilian officials in Geneva until Tuesday, 10 July 2001, only three days before the due date for this submission. Accordingly, Brazil has not had sufficient time to review the materials submitted by Canada in detail and is not yet prepared to comment fully on those materials. Brazil will make additional comments on Canada's responses to the Panel's questions in its statement to the second meeting of the Panel.

II. JURISDICTIONAL ISSUES

A. Brazil's Panel Request Satisfies the Requirements of Article 6.2 of the DSU

8. Canada has argued that Brazil's request for the establishment of a panel did not satisfy the requirements of Article 6.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). Brazil believes that its submissions on this issue on 22 June 2001 and 28 June 2001 respond fully to Canada's arguments, and therefore Brazil will not re-state the points made therein. However, Brazil makes the following points in response to the arguments made by Canada on jurisdiction in its response to the Panel's questions.

9. First, both Brazil's request for consultations and its request for the establishment of a Panel specifically refer to export credits and guarantees provided by Canada, by means of the Export Development Corporation, the Canada Account, and the Province of Québec, to the regional aircraft industry. In its response to the Panel's Question 5, Canada disputed that Brazil's request was limited to the regional aircraft industry, stating that certain of the indented and numbered paragraphs of Brazil's request for a Panel did not contain the "important qualifier 'for the regional aircraft industry.'" However, the very first sentence of the first paragraph of the panel request refers to the regional aircraft industry. The notion that Canada, reading further down the request, was unclear as to what industry was at issue in this dispute simply defies belief.[1] Nothing in Canada's submissions on the issue of jurisdiction provide any reasonable doubt that Brazil properly identified, and Canada was fully aware, that this dispute involved export credits to the regional aircraft industry.

10. It is also beyond doubt that Brazil's request involved three Canadian measures – EDC, Canada Account, and Province of Québec aid through Investissement Québec. Brazil has never referred to or discussed other measures, and Canada, in its response to the Panel's Question 5, appears to accept that Brazil's request identified Canada Account, EDC, and IQ as the measures at issue, albeit, in Canada's view, in "general and imprecise language."[2]

11. Second, Brazil has challenged these three programmes as subsidies within the meaning of Article 1 of the SCM Agreement that are contingent, in law or in fact, on export and are therefore prohibited within the meaning of Article 3 of the SCM Agreement. Canada has not alleged that Brazil is seeking to proceed based on articles of the SCM Agreement not identified in the request for a Panel.

12. Canada has suggested that Brazil's request was not sufficiently specific in that it did not list separately Article 1.1(a)(1)(i) of the SCM Agreement.[3] However, the Appellate Body has stated that a

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[1] Both the request for consultations and the request for establishment of a panel use the heading *Canada – Export Credits and Loan Guarantees for Regional Aircraft.* Canada has previously argued that the title given to the case is not relevant to the clarity of the panel request. However, had Brazil considered that the title given to the dispute unduly narrowed its claim, it would surely have pursued the matter with the Secretariat before submitting its request for the establishment of a panel.

[2] Canada's Answers to the Panel's Questions, 6 July 2001, page 5.

[3] Oral Statement of Canada on Jurisdictional Issues, 27 June 2001, para. 22.

reference to an article of a covered agreement in a panel request incorporates a claim of inconsistency with the subheadings of that article:

> [A]s the request for the establishment of a panel of the European Communities included a claim of inconsistency with Article 23, a claim of inconsistency with Article 23.2(a) is within the Panel's terms of reference.[4]

Brazil's panel request referred to the three challenged measures as violating Articles 1 and 3 of the SCM Agreement. In this respect, Brazil's request is comparable to that of Canada in *United States – Measures Treating Exports Restraints As Subsidies*, in which Canada's request claimed simply that certain US measures violated Article 1.1 of the SCM Agreement, but Canada's first written submission elaborated that the challenged measures treated exports restraints in a manner contrary to several subheadings of Article 1.1, including Articles 1.1(a)(1)(i)-(iv).[5]

13. Third, Brazil has specifically challenged export credits in the form of financing, guarantees, and interest rate support offered through these programmes. Brazil has not challenged any other operations of these programmes. While there may be issues in the course of these proceedings as to precisely how Canada provides financing, guarantees or interest rate support under these programmes, these are factual issues to be resolved in the course of the proceedings, and do not create jurisdictional issues or introduce any lack of clarity in Brazil's panel request.

14. Contrary to Canada's claims that Brazil has sought to "cure" alleged deficiencies in its panel request, Brazil's repeated descriptions of the scope of its panel request – financing, guarantees, and interest rate support provided by EDC, Canada Account, and Investissement Québec to the regional aircraft industry – have simply repeated *verbatim* the language of the panel request and explained how that language is clear, specific, and fully understood by Canada.

15. Nevertheless, it appears that Canada is unwilling to take "yes" for an answer on this issue. No matter how often Brazil explains that its request is as straightforward as described above, Canada continues to try to sow confusion. Canada's responses to the Panel's questions contain a perfect illustration of Canada's tactics and the resultant difficulties faced by Brazil in this respect. In Brazil's First Written Submission, Brazil stated its understanding that EDC provided guarantees to Comair. In response, Canada stated in its First Written Submission that EDC did *not* provide loan guarantees to Comair. Brazil indicated in its response to Canada's oral statement on jurisdictional issues that it would accept Canada's clarification on this point and adjust its arguments accordingly.

16. Now Brazil reads, in Canada's answer to the Panel's Question 11, of "EDC pricing offered to Comair." Evidently, EDC provided some sort of financing to Comair after all, though perhaps not in the form of a guarantee as Brazil previously understood. At this point, Brazil still does not know whether or how EDC financed Bombardier sales to Comair.

17. Canada's side-stepping on whether EDC was involved with Comair perfectly illustrates the problems with Canada's arguments on jurisdiction. Brazil notes that Canada failed to notify any of these programmes, failed to provide information at consultations, and now casts Brazil's inability to describe the operations of the three challenged programmes with perfect accuracy as creating a jurisdictional problem. Thus, in its statement to the Panel on jurisdiction, Canada pointed to alleged inconsistencies between Brazil's First Written Submission and its 25 June 2001 submission on

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[4] United States – Import Measures on Certain Products from the European Communities, WT/DS165/AB/R, para. 111 (Adopted 10 January 2001).

[5] *United States – Measures Treating Exports Restraints As Subsidies*, WT/DS194/2, Request for the Establishment of a Panel by Canada (25 July 2000). *See also* WT/DS194/R (29 June 2001) (Not yet adopted), paras. 5.20-5.28.

jurisdictional issues regarding descriptions of how these measures operate.[6] These alleged inconsistencies all relate to the details of the operations of the challenged measures. Like the issue of whether or how EDC supported the Comair transaction, the alleged inconsistencies are simply factual details regarding the three programmes that, while relevant to the resolution of the matters before the Panel, simply do not rise to the level of a lack of clarity as to the *identity* of the *measures* at issue.

18. In its response to the Panel's Question 6, Canada continues to allege that Brazil's request used "general and imprecise language" to describe the export credits at issue. However, Canada does not argue that Brazil would be in any way prohibited from requesting a Panel to examine *all* export credits provided by the three listed Canadian measures. In any event, Brazil's panel request did not challenge export credits of every hue. Instead, Brazil chose to enumerate the types of export credits – financing, guarantees, and interest rate support – at issue. In its response to the Panel's questions, Canada, while no longer arguing that Brazil's wording was the equivalent of "including but not limited to," continues to argue that the use of the word "including" was imprecise. The normal meaning of the word "including" is "if one takes into account; inclusive of."[7] The meaning of "inclusive," in turn, is "that includes, encloses, or contains." Absent any use of expansive language such as "but not limited to" or "*inter alia*," the word "including" should be given its normal construction of describing the relevant items within the whole set. In effect, Canada's objection appears to be that Brazil did not list all of the types of export credits that were *not* included in its request. Brazil is not aware of any obligation to do so, and submits that the fact that it did not do so in no way affects the clarity or specificity of the description of the types of export credits actually listed in its request.

19. In any event, Brazil's request does not give rise to the type of problems that led the Appellate Body to impugn the use of language such as "including but not limited to" in *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*.[8] In that case, the United States did not make any reference to Article 63 of the TRIPS Agreement in its panel request or, indeed, in its first written submission. In its oral statement at the first substantive meeting of the panel, however, the United States sought for the first time to raise Article 63 as an alternative claim, justified by the "not limited to" language of the panel request. The Appellate Body ruled that the phrase was not sufficient to bring the claim within the terms of reference of the panel.

20. The circumstances are very different in this case. First, Brazil's panel request does not contain any language comparable to the "but not limited to" phrase that could be interpreted as enabling Brazil later to expand the scope of its panel request. Second, Brazil has not in fact made any new or alternative claims subsequent to its panel request that have in any way gone beyond the contents of the panel request.

21. Canada now alleges that Brazil's request fails to comply with the requirements of Article 6.2 of the DSU because Brazil did not state that it was challenging the three named measures "as such, as applied, and in individual transactions." Brazil is not aware that the phrase "as such, as applied, and in individual transactions" is a term of legal art that must be included in each panel request. The argument whether the challenged measures – EDC, Canada Account, and IQ – violate the SCM Agreement "as such" or "as applied" goes to the substance of the dispute before the Panel, rather than the threshold issue of jurisdiction.

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[6] The more pertinent comparison would be between Brazil's request for a panel and its subsequent submissions, but Canada has not alleged any inconsistencies between the request for a panel and Brazil's subsequent descriptions of its claim.

[7] THE NEW SHORTER OXFORD ENGLISH DICTIONARY (Third Ed., 1993), pgs. 1337-38. The Latin root of "to include" is "*in* + *claudere*, to shut in, enclose."

[8] WT/DS50/AB/R (Adopted 16 January 1998), para. 90.

22. Canada's position in this case is diametrically opposed to the position it took in *United States – Exports Restraints*. In that case, the United States argued that Canada's request for a panel failed to satisfy the requirements of Article 6.2 of the DSU because Canada failed to make clear whether its challenge to the US measures was "as such" or "as applied." The United States also objected to the vagueness of Canada's identification of the US "practices" at issue.[9] In response, Canada argued that the United States in effect claimed that because its measures were not mandatory, they were not properly before the Panel and should be dismissed. In Canada's view, however, the question whether a measure was mandatory or discretionary "is an issue that addresses whether that measure as such violates the GATT provisions invoked, not whether a panel has jurisdiction to hear a particular matter."[10] According to the Panel, Canada characterized the US requests for a preliminary ruling as an effort "to distract this Panel from its true task: resolving the dispute between Canada and the United States."[11] The Panel agreed with Canada, and declined to make a preliminary ruling on the ground that the Article 6.2 issues raised by the United States went to the substance of Canada's claims, and therefore were properly addressed as part of the substantive analysis of the claims.[12]

23. The position taken by Canada, and indeed the Panel, in *United States – Exports Restraints* applies with equal force in this case. The question whether Canada's measures constitute "as such" or "as applied" violations of the SCM Agreement goes to the essence of the substantive issues that must be interpreted by the Panel. Resolution of these issues will depend on the Panel's analysis of the factual evidence before it regarding the nature and operation of the measures.[13] As Canada put it in *United States – Exports Restraints*, the Panel should not be distracted from that analysis.[14]

24. This distinction between jurisdictional and substantive issues is also consistent with the reasoning of the Appellate Body in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products*, where the Appellate Body, referring to its decision in *European Communities – Bananas*, "observed that there is a significant difference between the *claims* identified in the request for the establishment of a panel . . . and the *arguments* supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions, and the first and second panel meetings with the parties as a case proceeds."[15] Thus, the Panel in *United States – Exports Restraints* considered Canada's claim to be that the United States' measures violated Article 1.1 of the SCM Agreement, and the questions whether the US measures were mandatory or discretionary, or "as such" or "as applied" violations, to be substantive arguments supporting these claims. Similarly, in this case, Brazil claims that the three listed forms of export credits provided by EDC, Canada Account, and IQ, which it argues constitute subsidies under Article 1 of the SCM Agreement, are violations of Article 3 of the Agreement. These claims are "significantly different" from the arguments that Brazil may advance in support of the claims, and that the Panel must address in the course of its substantive analysis.

25. In its response to the Panel's Question 6, Canada argues that "if a measure is not identified in the request for establishment of a panel," the measure is outside the panel's terms of reference "regardless of whether or not the respondent has suffered prejudice." There are two flaws in Canada's argument. First, Brazil does not understand Canada to argue that Brazil has raised claims regarding measures that were not identified in the panel request, but rather that "for all three programs Brazil's request used general and imprecise language." There is a difference between failing to identify a measure in the panel request, and whether or not the language used to identify a measure was "general

[9] WT/DS194/R, para. 4.24-4.27.
[10] *Id*., paras. 4.60-61.
[11] *Id.*, para. 4.81.
[12] *Id.*, para. 8.2.
[13] Please refer also to Brazil's answer to the Panel's question 27.
[14] WT/DS194/R, para. 4.81.
[15] WT/DS50/AB/R, para. 88 (emphasis in original).

and imprecise." Moreover, Canada's position regarding the relevance of prejudice appears to contradict the position it took in *United States – Exports Restraints*, in which Canada opposed the US Article 6.2 claim on the ground that the United States had not been prejudiced because it was able to respond fully to Canada's claims.[16]

26. Finally, Canada alleges that its due process rights have been violated by the alleged lack of clarity or specificity in Brazil's request for the establishment of a panel. Brazil notes, however, that Canada has failed to provide any evidence that its ability to defend itself before this Panel has actually been delayed, complicated, or otherwise frustrated by this alleged lack of clarity.

27. In contrast, Canada's actions thus far have caused serious practical difficulties for Brazil. First, as Brazil has previously explained, Canada failed to provide substantive responses to Brazil's questions during consultations. The Appellate Body in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* stated that the due process demands of the DSU make it especially necessary that "facts must be disclosed freely" during consultations.[17] The Appellate Body recognized that "the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings."[18] To the extent that Canada feels that a perceived lack of clarity in Brazil's panel request has caused confusion as to the matters at issue – and Brazil strenuously disputes Canada's claim that it has suffered any such prejudice – Canada's failure to respond fully during consultations "did much" to shape Brazil's panel request.

28. Moreover, as the Panel is aware, Canada chose not to share its response to the Panel's 20 June 2001 request for information regarding the Air Wisconsin transaction with Brazil in a timely manner and as required by the Panel's working procedures. Canada also failed to deliver the exhibits to its responses to the Panel's questions to the Brazilian Mission in Geneva in a timely fashion on 6 July 2001. On both occasions, Canada failed to request that both Parties be allowed equal additional time to submit their data. Accordingly, while Canada obtained both of Brazil's submissions in a timely fashion, Brazil had no time to review Canada's Air Wisconsin materials before the Panel's meeting on 27-28 June 2001, and insufficient time to review Canada's responses to the Panel's questions before the due date of this submission.[19] As a practical matter, therefore, Canada's actions in this matter have had a much greater impact on Brazil's due process rights than Brazil's alleged "general and imprecise language" has had on Canada.

B. The Panel Is Not Precluded by *Res Judicata* from Addressing Brazil's Claims

29. In its questions to the Parties, the Panel asked whether the principle of *res judicata* precluded its review of Brazil's claims regarding EDC's Corporate and Canada Accounts "as such." The *res judicata* principle means that once a matter has been settled by judgment, it may not again be the subject of a claim. Canada appears unclear as to whether the principle actually applies to WTO disputes, noting only that it "may be" a generally recognized principle of law. While there is no WTO precedent on the applicability of the principle, Canada points out that the Panel in *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* found that panels are not legally bound by previous decisions of panels or the Appellate Body, even if the subject matter is the same. This makes clear that *res judicata* does not apply.

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[16] WT/DS194/R, para. 4.80.
[17] WT/DS50/AB/R, para. 94.
[18] *Id.*
[19] Brazil understands and sympathizes with the difficulties faced by Canada in assembling the extensive documents requested by the Panel in a relatively short period of time. Brazil faces similar difficulties and therefore is always willing to attempt to accommodate other parties' reasonable scheduling requests. However, Brazil strenuously objects to other Members attempting to turn the dispute settlement process into a litigation game in which one side manipulates the procedural rules to gain advantage.

30. In arguing that *res judicata* does not apply, however, Brazil does not mean to suggest that disappointed parties may continue to use the dispute settlement process over and over again to litigate the same claim until a favourable result is obtained. Nevertheless, because the entire purpose of the dispute settlement mechanism is to enable Members to preserve their rights and obligations under the covered agreements, a Member should not be denied access to that mechanism in circumstances where previous recourse to that mechanism did not fully resolve the matter in dispute and where intervening events cause additional concern regarding the Member's rights and obligations.

31. In any event, as Brazil explained in its answers to the Panel's questions, the issues before this Panel have *not* been settled by the decisions in the earlier *Canada – Aircraft* dispute.[20] The Panel in that case declined to make the findings requested by Brazil that EDC and Canada Account, as such, violated the SCM Agreement, stating that Brazil "failed to demonstrate" its claims.[21] Brazil appealed the Panel's decision, noting that Canada had failed to provide much of the information necessary to Brazil's claim (and information that was the subject of specific requests from the Panel for the production of documentary evidence by Canada), and argued that the Panel should have drawn adverse inferences.

32. While it did not specifically consider the applicability of *res judicata*, the Appellate Body considered that its and the Panel's decisions in *Canada – Aircraft* would not preclude Brazil from "pursuing another dispute settlement complaint against Canada, under the provisions of the SCM Agreement and the DSU concerning the consistency of certain of EDC's financing measures with the provisions of the SCM Agreement." [22] It is unlikely that the Appellate Body would have made this statement if it considered that any applicable doctrine of law could operate to bar a subsequent claim by Brazil.

33. Moreover, the circumstances in which the *Canada – Aircraft* Panel declined to make Brazil's requested "as such" findings also mitigate strongly against any possible application of *res judicata* to Brazil's current claims. As noted in Brazil's answer to the Panel's Question 2, Canada refused to provide the previous Panel with the information that would have enabled it to decide – one way or the other – Brazil's "as such" claims regarding EDC and Canada Account.[23] Canada therefore has no-one but itself to blame for the fact that the *Canada – Aircraft* Panel was unable to make final decisions regarding Brazil's claims that might implicate *res judicata* in this matter.

34. In its response to the Panel's questions, Canada stated that the Panel need not decide whether the principle applies to WTO disputes, because, in Canada's view, Brazil has "failed to offer any evidence or arguments that would warrant this panel departing from the findings" of the Panel in the previous *Canada—Aircraft* case.[24] As discussed above, there are simply no findings regarding the "as such" claims that could possibly implicate *res judicata* in this case. Moreover, the issue whether Brazil's evidence or arguments warrant this Panel making the requested findings goes to the substance of the matters before the Panel, rather than the jurisdictional question whether the Panel may address these claims at all.

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[20] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R (Adopted as modified by the Appellate Body 20 August 1999).

[21] WT/DS70/R, paras. 9.129, 9.213.

[22] Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/AB/R (Adopted 20 August 1999), para. 206.

[23] Examples of Canada's failure to provide information specifically requested by the Panel in *Canada – Aircraft* are included in WT/DS70/R at paras. 6.80, 6.171, 6.203, 6.258, 6.259, 6.260, 6.279, 6.303, 6.304, 6.326, 6.327, 9.176, 9.188, 9.218, 9.244, 9.253, 9.272, 9.293, 9.294, 9.299, 9.303, 9.313, 9.314 (note 621), 9.327, 9.345, 9.347 (note 633).

[24] Canada's Answers to the Panel's Questions, 6 July 2001, Question 2.

35. Brazil's current "as such" claims against EDC, the Canada Account and IQ are based to a significant degree upon arguments and evidence that were not presented to the earlier *Canada – Aircraft* Panel. Indeed, much of the evidence that Brazil has presented to the current Panel did not come to light until quite recently due, in part, to the lack of transparency in Canada's export credit scheme. Brazil was unaware, for example, of the extent to which EDC operates through the market window and provides financing below the terms set forth in the OECD Arrangement until Canada admitted this fact during the Article 21.5 proceedings in *Brazil – Aircraft*.[25] Canada had also apparently been less than forthcoming with other OECD Participants about this conduct, likely because many, including the United States, have condemned market window activities.[26] Brazil notes, for example, that Canada apparently considers its "market window" policy to be secret; it has requested confidential treatment for a [ ].

36. New evidence continues to come to light. With its responses to the Panel's questions, Canada for the first time discloses four Decrees that explain how the Société de développement industriel du Québec ("SDI"), and now IQ, are used to support sales of Bombardier aircraft. Exhibits Cda-33 to Cda-36 were never considered by the *Canada – Aircraft* Panel. That Panel also did not consider the evidence concerning IQ contained in Exhibit Bra-9.

37. Similarly, in Canada's Second Written Submission of 4 December 1998 in the earlier *Canada – Aircraft* dispute, Canada stated that *none* of the guarantees or financing activities under the "export development" eligibility criterion of SDI (which became IQ in 1998) was related to the civil aircraft sector.[27] The Panel in *Canada – Aircraft*, at paragraph 9.275, accepted Canada's statement and found that, "Brazil has failed to adduce any evidence of IQ assistance to the Canadian regional aircraft sector." In Exhibit Bra-9, however, dated 11 January 2001, IQ spokesman Jean Cyr admits that IQ created a five-year fund *in 1996* to provide loan guarantees to Bombardier customers. This new evidence directly contradicts Canada's claim to the previous Panel that IQ was not used to finance the civil aircraft sector, and demonstrates that there are new facts about IQ for this Panel to consider.

38. This Panel also has new evidence regarding Canada Account. For example, like IQ, the earlier *Canada – Aircraft* Panel did not have the benefit of Exhibits Cda-15 to Cda-24, even though these exhibits reveal the means by which Canada Account provides funds and guarantees to Bombardier customers. In addition, EDC's Canada Account has fundamentally changed since it was first considered in *Canada – Aircraft*.[28] When coupled with Brazil's new arguments and evidence, these facts require re-examination of the Canada Account program "as such." The same is true, as discussed above, for EDC, and IQ.

39. Brazil has provided its substantive arguments regarding this evidence both in its previous submissions and below. As noted above, the reports in the earlier *Canada – Aircraft* dispute clarify that Brazil's "as such" claims were not proven based on the evidence available to Brazil at the time and provided to the Panel. Whether the cumulative effect of the "old" evidence put before the previous Panel and the "new" evidence presented for the first time to this Panel is now sufficient to prove Brazil's claims is a substantive, rather than a jurisdictional, issue for this Panel to decide.

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[25] Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW (Adopted as modified by the Appellate Body 4 August 2000), para. 81.

[26] Lawrence H. Summers, "The Importance of Continuing to Fight Against International Trade Finance Subsidies," Remarks at the 65th Anniversary of the Export Import Bank, 16 May 2000, pg. 3 ("Summers speech") (Exhibit Bra-29).

[27] *See* Exhibit Bra-52, which includes the relevant excerpt (para. 117) from Canada's 4 December 1998 Second Written Submission.

[28] *See*, *e.g.*, the Policy Directive submitted by Canada as Exhibit Cda-16, which post-dates the Panel Report in *Canada – Aircraft*.

III. EDC SUPPORT TO THE CANADIAN REGIONAL AIRCRAFT INDUSTRY CONSTITUTES PROHIBITED EXPORT SUBSIDIES

A. EDC's Corporate Account and EDC's Canada Account "As Such"

40. Brazil argues that EDC's Corporate and Canada Accounts constitute prohibited export subsidies "as such." Before further discussing the evidence in support of this argument, Brazil would like to address two threshold issues.

41. First, Canada's rebuttals to Brazil's claims focus entirely on the question whether EDC's Corporate and Canada Accounts provide benefits "as such." Canada does not dispute that EDC support is *de jure* conditioned on export. Brazil focuses, therefore, on Canada's claim that EDC Corporate and Canada Account financial contributions do not confer benefits "as such."

42. Second, Canada's claim that the previous Panel addressing EDC's Corporate and Canada Accounts affirmatively found these measures to be consistent "as such" with the SCM Agreement is inaccurate. As noted above, the Panel in *Canada – Aircraft* concluded that, as an evidentiary matter, Brazil "failed to demonstrate" that EDC's Corporate and Canada Accounts constituted mandatory legislation subject to challenge "as such."[29] In its submissions to this Panel, Brazil has presented newly-available evidence and added it to the evidence presented to the *Canada – Aircraft* Panel. Brazil believes it has now met the burden of making a *prima facie* case that EDC's Corporate and Canada Accounts are mandatory and constitute prohibited export subsidies "as such."

1. EDC Is an Export Credit Agency and As Such Requires the Provision of Subsidies Contingent Upon Export

43. Brazil's claims encompass both the Corporate Account and the Canada Account, which are the two sides of one programme, EDC. As Canada notes in paragraph 4 of its First Written Submission, "EDC administers two programs, the Canada Account and the Corporate Account."[30] When EDC provides "official support," it does so mostly through the Canada Account.[31] When EDC operates through the "market window" and provides, as Canada alleges, financing according to "what the relevant borrower has recently paid in the market for similar terms and with similar security," it does so through the Corporate Account.[32]

44. Whether operating through the Corporate Account or through the Canada Account, EDC "as such" provides export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement. As discussed in detail in Brazil's 6 July responses to Questions 28 and 29 from the Panel, EDC's Corporate and Canada Accounts "as such" require the provision of export subsidies because they are established and operate as export credit agencies ("ECAs") with the *raison d'etre* of providing export subsidies.

45. The history and existence of the "safe haven" in item (k) of the Illustrative List of Export Subsidies, which Canada has invoked to justify its Air Wisconsin subsidy, illustrates this fact. During the negotiation of the Tokyo Round Subsidies Code, the participants in the recently-concluded OECD Arrangement were faced with the fact that their ECAs, while permitted by the Arrangement, would nonetheless be inconsistent with their obligations under the Code. Their solution was the

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[29] WT/DS70/R, paras. 9.129, 9.213.

[30] A similar statement is contained in paragraph 20 of Canada's First Written Submission.

[31] For a more detailed discussion, *see* paras. 74-81 of Brazil's First Written Submission and paras. 38-43 of Brazil's Statement for the First Meeting of the Panel.

[32] Canadian First Written Submission, para. 67 (emphasis removed).

second paragraph of item (k).[33] Export credits provided by ECAs are export subsidies, the negotiators recognized, but they will not be considered prohibited export subsidies so long as they comply with the interest rate provisions of the Arrangement. If an ECA is not covered by the safe haven of item (k), it is providing a prohibited subsidy "as such" because providing export subsidies, as the Tokyo Round negotiators realized, is inherent in the very existence and functioning of an ECA. That is, again, why they created the second paragraph of item (k) in the first place.

46. Brazil's arguments that EDC support *via* the Corporate and Canada Accounts constitutes export subsidies "as such" must be viewed in that context. EDC, whether through its Canada Account or its Corporate Account operations, constitutes a measure that is indeed designed "as such" to provide export subsidies. Like other ECAs, EDC does not pay income taxes, does not pay dividends, and borrows on the credit of the Government of Canada.[34] The OECD Arrangement was meant to limit the extent to which these advantages could be abused.

47. Brazil is not saying, as Canada argues at paragraph 37 of its First Written Submission, "that because EDC is a government entity and as such does not pay income taxes, *any* financing by it constitutes a subsidy." Brazil's argument is that not paying taxes is illustrative of, and an essential prerequisite to, an ECA's capability to perform its normal mission – to provide export subsidies. As noted by former US Treasury Secretary Lawrence Summers:

> . . . Market Window institutions either directly, or potentially, contravene [OECD] Arrangement rules because they are controlled and implicitly subsidized by the state. Thus, Market Window institutions operate with an unfair competitive advantage because they benefit from special government concessions including guarantees by the state that enable them to raise funds at a lower cost than their private sector competitors, and because they are exempted from certain taxes and dividend payments. At the same time they act like official export credit agencies in restricting financing to national exporters.[35]

48. Brazil's claims encompass different forms of EDC financial contributions provided *via* the Corporate and Canada Accounts – guarantees, loans and financial services. The advantages EDC wields as a government ECA mean that when it provides these financial contributions, it confers benefits "as such." That is the very reason the OECD Arrangement was adopted – to control the way in which those benefits could be conferred. Simply saying that an ECA operates "on commercial principles" does not erase the advantages addressed by Secretary Summers, or the importance of the OECD Arrangement's rules to limit potential abuse. In this context, the market window standard outlined by Canada does not turn a mandatory measure into a discretionary one.

2. Specific Examples Illustrate that EDC Is an Export Credit Agency and As Such Requires the Provision of Subsidies Contingent Upon Export

49. Specific types of financial contributions challenged by Brazil illustrate the extent to which EDC confers benefits "as such." These are described below.

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[33] JOHN E. RAY, MANAGING OFFICIAL EXPORT CREDITS – THE QUEST FOR A GLOBAL REGIME, Institute for International Economics (1995), pgs. 36-38 (Exhibit Bra-54).

[34] Export Development Corporation 1999-2000 Reference Guide, pg. 9 (Exhibit Bra-23).

[35] Summers speech, pg. 3 (Exhibit Bra-29).

(a) Loan Guarantees

50. Loan guarantees provided by EDC's Corporate and Canada Accounts confer benefits by according "terms more favourable than those available to the recipient on the market."[36] As Canada has noted, where there is a government loan guarantee, "the lending bank establishes financing terms in the light of the risk of the . . . Government, not the borrower."[37] Similarly, EDC's Resolution Respecting Minimum Lending Yields, submitted by Canada as Exhibit Cda-47, provides that "where financing is to be secured by a guarantee, the credit rating of the guarantor shall be used . . . ."

51. EDC, as an agent of the Government of Canada, enjoys a credit rating of AAA from Standard & Poors.[38] An EDC loan guarantee allows purchasers of Canadian regional aircraft, who do not enjoy similar standing, to enjoy the benefits of EDC's AAA rating, which will certainly help them secure better financing terms than they could secure on their own. Thus, EDC guarantees provide benefits "as such."

52. Canada asserts that EDC charges fees for its guarantees,[39] but has nowhere demonstrated that the fees it charges regional aircraft purchasers are commensurate with those charged by commercial guarantors with AAA credit ratings to regional aircraft purchasers wishing to enjoy the benefits of those guarantors' AAA ratings. Even if it could do so, the EDC guarantee would still confer a benefit as long as "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."[40] In this regard, Brazil would note that loan guarantees are listed specifically in item (j) of the Illustrative List of Export Subsidies in Annex I to the Agreement, and are, *per se*, prohibited.

(b) Financial Services

53. Similarly, Brazil has demonstrated that EDC financial services confer benefits "as such." Under Article 1.1(a)(1)(iii) of the SCM Agreement, financial contributions can take the form of "services other than general infrastructure." The ordinary meaning of the term "services" is "assistance or benefit provided to someone by a person or thing."[41] EDC financing support and financing packages for Canadian regional aircraft purchasers, as well as the financing and loan guarantees that are part of that support and those packages, constitute assistance to the Canadian regional aircraft industry and its purchasers.

54. Canada has acknowledged that EDC provides its financing support and financing packages on terms more favourable than a recipient could receive on the market. According to the EDC, it "*complements* the banks and other financial intermediaries," and absorbs risk for Canadian exporters "*beyond what is possible* by other financial intermediaries."[42] Additionally, "EDC's financing support gives Canadian exporters an *edge* when they bid on overseas projects,"[43] which Canada has explained refers to "the ability of EDC officials to assemble *better structured financial packages* . .."[44] All of these services – financial packages that are better structured, assistance that complements and

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[36] WT/DS70/AB/R, para. 158.
[37] WT/DS46/RW, Annex 1-2 (para. 36) (emphasis added).
[38] Export Development Corporation Annual Report 2000, pg. 41 (Exhibit Bra-22).
[39] Canadian First Written Submission, para. 84.
[40] SCM Agreement, Article 14(c).
[41] The New Shorter Oxford English Dictionary (Third Ed., 1993), pg. 2789.
[42] EXPORT DEVELOPMENT CORPORATION, *1995 Chairman and President's Message*, pgs. 4, 2 (emphasis added) (Exhibit Bra-24).
[43] WT/DS70/R, para. 6.57 (*quoting* former EDC President Paul Labbé) (emphasis added).
[44] WT/DS70/R, para. 9.163 (emphasis added).

goes beyond that provided by commercial banks, support that grants an edge – by definition offer something better than that available to Canadian exporters on the market. They therefore confer benefits.

55. As noted in paragraph 28 of Brazil's Oral Statement, the *Canada – Aircraft* Panel did not find, as Canada claims, that a determination of benefit "cannot be inferred or extrapolated from the generic statements of the EDC or its officials."[45] That Panel found that evidence provided by Brazil, including some statements by officials, did not establish that EDC provides lower interest rates than are commercially available. In this dispute, Brazil's claim is different and in fact broader; it is that these statements establish that EDC provides "services" that are better than what a recipient could get on the market. Canada's argument should therefore be rejected.

56. The European Communities' ("EC") suggestion that "services" can only be "financial contributions" if they are offered "for less than full consideration" or if they "involve a cost to the government" must also be rejected.[46] This argument improperly collapses the "financial contribution" and "benefit" elements of a prohibited export subsidies claim.[47]

57. Moreover, even if directed to the "benefit" element of a prohibited export subsidies claim, the EC's argument harkens back to the so-called "cost to government" interpretation, which was rejected by the Appellate Body in the earlier *Canada – Aircraft* case.[48] A "benefit" is conferred when a recipient gets a financial contribution on terms more favourable than it could receive on the market. The evidence cited by Brazil demonstrates that EDC provides services – financial packages that are better structured, assistance that complements and goes beyond that provided by commercial banks, support that grants an edge – that by definition offer something better than Canadian exporters or their customers can get on the market.

58. The EC also appears to argue that the relevant benchmark against which to judge whether services confer benefits is "the conditions on which equivalent services are offered by the government elsewhere in the Member concerned."[49] Again, however, the EC fails to apply the "benefit" standard adopted by the Appellate Body in *Canada – Aircraft*. The relevant question is whether a Member grants a recipient something better than what that recipient or its customer could get on the market. A Member does not avoid conferring a "benefit" by granting services on similarly below-market terms to several different recipients.

(c) EDC's Benchmark

59. Finally, with respect to EDC's Corporate Account, Canada claims that it operates "on commercial principles," providing financing according to "what the relevant borrower has recently paid in the market for similar terms and with similar security."[50] Similarly, Canada claims that "official support" *via* EDC's Canada Account does not confer a benefit when it operates according to this standard.[51] With this standard, Canada considers that it does not provide export subsidies *via* EDC's Corporate Account, since it does not confer a "benefit," within the meaning of Article 1.1(b)

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[45] Canadian First Written Submission, para. 77.

[46] EC Third Party Submission, paras. 46, 51; EC Oral Statement, para. 24.

[47] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (Adopted 20 August 1999), para. 157.

[48] WT/DS70/AB/R, para. 156.

[49] EC Third Party Submission, para. 50.

[50] Canadian First Written Submission, para. 67 (emphasis removed).

[51] Specifically, in the Air Wisconsin transaction, Canada claims that if Brazilian government support was not involved, and Canada was only matching Embraer's offer, then Canada Account support "would be on terms no more favourable than those available to the recipient on the market." Canadian Oral Statement, para. 16.

of the SCM Agreement. This standard, however, masks (i) the nature of the benefit, and (ii) the true beneficiary.

60. The Appellate Body, borrowing context from Article 14(b) of the Subsidies Agreement, would compel a "benefit" standard requiring that EDC operations not extend support beyond "the terms the borrower would have been able to obtain on the purely commercial market."[52] In contrast, Canada states that EDC operates "on commercial principles," and asserts that this equates with market pricing and the provision of financing at market rates.[53]

61. There is a difference between operating on commercial principles and actually financing at market rates, however. This is because in many instances, products and terms offered by EDC are not available on the commercial market. Brazil has noted, for example, how Canada heralds EDC's ability to "complement" the services of banks and other financial intermediaries, or in other words, its ability to provide things that the commercial market does not provide. As the United States notes at paragraph 7 of its Third Party Submission, the appropriate benchmark against which to judge whether EDC provides terms more favourable than available on the market must be *terms that are actually available on the commercial market*. Just operating "on commercial principles" is not enough – the benchmark for EDC's market window operations must be what is available on the market itself.

62. A further problem with Canada's benchmark is that it focuses only on the purchaser of Canadian regional aircraft as the beneficiary of EDC financial contributions. Another beneficiary, however, is the producer of the aircraft, Bombardier. It is undisputed that producers of aircraft frequently are expected to provide financing for their customers. The question, therefore, is whether – in the absence of EDC – Bombardier could make equally attractive financing available to its customers. If not, then in order to keep the monthly payment required by customers no higher than it would be with EDC support, Bombardier would have had to cut its price. Whether Air Wisconsin, for example, could have obtained terms as favourable as those offered by EDC elsewhere in the market is irrelevant if *Bombardier* could not obtain them. This conclusion applies to all "market window" operations of EDC's Corporate Account and, therefore, to the programme "as such." If Bombardier were able to find equally favourable financing elsewhere, market window operations would be completely unnecessary – since, supposedly, they are no more than what is already available in the market. But, of course, this again raises the question: if EDC's market window does no more than offer what the market offers, what is the function of EDC? Canada never explains.

3. Canada's Reliance on the Affirmative Defence of the "Safe Haven" of Item (k) Does Not Affect the Mandatory Nature of the Measures

63. Consistent with the intent of the negotiators of the Tokyo Round Subsidies Code, and the SCM Agreement, the "safe haven" included in the second paragraph of item (k) is potentially available for EDC's operations. But the presence of this potential defence does not affect the nature of EDC "as such." The potential availability of an affirmative defence does not change a mandatory measure into a discretionary measure. As discussed above and in Brazil's response to Question 28 from the Panel, item (k) was drafted and adopted to provide a limited *exception to the prohibition, not to the mandatory character of the export subsidy*. A measure that exists to provide export subsidies remains mandatory whether or not it may fall within the scope of the "safe haven" of item (k).[54]

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[52] *See* US Third Party Submission, para. 6.

[53] Canadian First Written Submission, para. 67.

[54] Nor does the presence of the potential defence under item (k) affect the nature of the programmes "as such," even if in some cases financing might be covered by item (k). As also discussed in Brazil's response to Question 28 from the Panel, even if the programmes might not always require a violation of the SCM Agreement, they would still be inconsistent with the SCM Agreement "as such."

64. A good analogy is Article 27 of the SCM Agreement. It contains a temporary, eight-year exception from Article 3 of the SCM Agreement for developing countries meeting certain conditions. It is a matter of affirmative defence. The availability of the defence does not change the character of the export subsidy; it simply makes the prohibition temporarily inapplicable. Likewise, item (k), second paragraph, provides a safe haven for qualifying export credits without regard to whether they are "mandatory" or "discretionary."

B. EDC's Corporate and Canada Accounts "As Applied"

65. In its First Written Submission, Brazil identified five regional aircraft transactions demonstrating that as applied, EDC's Corporate and Canada Accounts provide prohibited export subsidies.[55] Because one of those transactions – Air Wisconsin – involves Canadian resort to the "safe haven" of item (k), Brazil will rebut Canada's arguments with respect to that transaction in a separate section of this submission.

66. Of the four remaining customers identified by Brazil, Canada asserted that neither Midway nor Comair received EDC support. Specifically, Canada says EDC's Corporate Account did not participate in the Midway transaction.[56] In Canada's 6 July response to Question 14 from the Panel, Brazil now learns that support for the Midway transaction came from IQ. This is further evidence of how Canada's tactic of "stonewalling" in consultations has denied Brazil the due process to which it is entitled. Brazil will address IQ support for the Midway transaction in Section V below.

67. Canada also stated that EDC's Corporate Account did not provide loan guarantees for the Comair transaction.[57] As noted above, however, Canada does not deny the evidence submitted by Brazil[58] that the Comair transaction involved either EDC Corporate Account support in a form other than guarantees, or guarantees from some other instrumentality of the Canadian government (one example might be the Canada Account). Brazil notes, for example, Canada's statements, in paragraphs 3-4 of its 6 July response to Question 11 from the Panel, that pricing for ASA [ ] on "EDC pricing offered to Comair." Given Canada's failure to be fully forthcoming with information regarding the Comair and Midway transactions, Brazil requests that the Panel specifically ask Canada whether a government guarantee or other support was provided to Comair or Midway, and through which Canadian government agency it was provided.

68. Moreover, Brazil asks the Panel to recall Canada's admission, in another proceeding, that the EDC Corporate Account has extended fixed interest-rate export credits at interest rates below the OECD Arrangement's minimum interest rate, the CIRR.[59] Brazil discussed these transactions at paragraph 56 of its First Written Submission, and again at paragraphs 34-35 of its Oral Statement. These financial contributions confer a benefit. The Panel will recall the Appellate Body's statement in *Brazil – Aircraft* that a net interest rate to a borrower below the relevant CIRR is "positive evidence" that the rate secures a "material advantage," under item (k) of Annex I to the Subsidies Agreement.[60] As discussed at paragraphs 51-54 of Brazil's First Submission, export support that confers a "material advantage" will always confer a benefit, since item (k) and the "material advantage" standard only become an issue when a subsidy, including a benefit, has already been demonstrated.

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[55] Brazilian First Written Submission, paras. 43, 59.
[56] Canadian First Written Submission, para. 64.
[57] Canadian First Written Submission, para. 65.
[58] Brazilian First Written Submission, paras. 43, 59.
[59] WT/DS46/RW, para. 6.99 (The Panel was "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.").
[60] WT/DS46/AB/R, para. 182.

69. Canada has not identified the specific transactions involved, except to state that they occurred sometime after 1 January 1998.[61] Because rates below CIRR constitute "positive evidence" of material advantage and benefit, Brazil requests that the Panel specifically ask Canada for details regarding these transactions.

70. Brazil will now turn to the two remaining customers discussed in its First Written Submission, ASA and Kendell. Canada provided information regarding the terms of EDC Corporate Account support for sales to those customers with its 6 July responses to Question 11 from the Panel.

1. ASA

71. ASA Holdings, Inc. and Atlantic Southeast Airlines (collectively "ASA") described certain of the terms underlying its purchase of Canadian regional aircraft in filings with the US Securities and Exchange Commission ("US SEC"). Brazil discussed those terms in paragraphs 43 and 59 of its First Written Submission, and in Exhibits Bra-36 through Bra-38. Canada has provided further details regarding EDC support in its 6 July response to Question 11 from the Panel. EDC financing for sales to ASA conferred and continues to confer a benefit, within the meaning of Article 1.1(b) of the SCM Agreement, in two ways.

72. First, as noted in the US SEC documents included in Exhibits Bra-36 through Bra-38, EDC financing support exceeded the 10-year maximum repayment term included in the OECD Arrangement for regional aircraft. As discussed in paragraphs 50-54 of its First Written Submission, terms beyond the 10-year maximum constitute "positive evidence" of a benefit, within the meaning of Article 1.1(b) of the SCM Agreement.

73. In its response to Brazil's argument, Canada claims that "[s]tandard commercially available financing terms for regional aircraft range from 10 to 18 years" and that, therefore, EDC financing is "entirely within the ordinary commercial range."[62] In its 6 July response to Question 35 from the Panel, Brazil refutes this assertion. Brazil's research into the activities of the two large, international banks named by Canada, the results of which are included in Exhibit Bra-57, shows no indication that the market supports terms of financing for regional aircraft in the range alleged by Canada.

74. Second, Canada's 6 July response to Question 11 from the Panel, and Exhibits Cda-42 through Cda-44, demonstrate that EDC financial contributions were granted on terms more favourable than those available on the market. In its response to Question 11 from the Panel, Canada describes how it provided financing to ASA in March 1997 and August 1998 at a rate of the [] plus [] basis points, which it describes as [ ] basis points [ ]. The Panel in the earlier *Canada – Aircraft* dispute had occasion to refer to [ ]. After first noting that an EDC Standing Board Resolution of 17 June 1992 applies to all EDC Corporate Account lending, including that for regional aircraft, the Panel then noted that "EDC's lending yield must cover cost plus a minimum risk margin (which varies according to the credit rating of the recipient)."[63] The Panel then went on to observe that, "Brazil makes no attempt to suggest that this policy is inconsistent with that of commercial banks."[64] Based on this lack of evidence, the Panel concluded, "we are not convinced by Brazil's argument that EDC's net interest margin does not provide sufficient basis for comparing EDC's debt financing performance with that of commercial banks."[65]

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[61] Canadian First Written Submission, para. 71.

[62] Canadian First Written Submission, para. 75.

[63] WT/DS70/R, para. 9.173. The undated EDC "Resolution Respecting Minimum Lending Yields" included as Exhibit Cda-47 appears to be the same document to which the earlier Panel referred.

[64] *Id*.

[65] *Id*. para. 9.174.

75. Brazil made no attempt, as the Panel said, because the opaque nature of EDC and its operations prevented Brazil from obtaining the relevant information. Now, Canada's answer to Question 11 provides relevant information. That answer makes clear that not only in the ASA transaction, but even in all other transactions where its [] is achieved, Canada, in fact, provides below market financing. Canada states, at paragraph 4 of its response to Question 11, that it provided financing at [] to ASA, [] basis points below its []. The OECD Commercial Interest Reference Rate, it will be recalled, is 100 basis points above the seven-year US Treasury Bill. As of the writing of this submission, T-Bill plus []. But the CIRR, by itself, does *not* include a risk premium. Thus, while CIRR alone may be sufficient to secure the "safe haven" in the second paragraph of item (k), it is not enough to avoid conferring a benefit. []{66} The prime rate, however, is available only to borrowers with the best credit ratings, and even Canada does not argue that regional carriers are candidates for the prime rate. Thus, EDC's [] would confer a benefit on a borrower worthy of the prime rate, to say nothing of a regional airline, or especially a regional airline like ASA that gets an [] the already subsidized rate. Indeed, Canada's Exhibit Cda-47, which is EDC's "[]" suggests that EDC's [].

2. Kendell

76. Press reports described certain of the terms involved in EDC support for the sale of Canadian regional aircraft to Kendell Airlines. Brazil discussed those terms in paragraphs 43 and 59 of its First Written Submission, and in Exhibits Bra-34 through Bra-35. Canada has provided further details regarding EDC support in its 6 July response to Question 11 from the Panel. EDC financing for the sale to Kendell conferred and continues to confer a benefit, within the meaning of Article 1.1(b) of the SCM Agreement, in two ways.

77. First, EDC financing support exceeded the 10-year maximum repayment term included in the OECD Arrangement for regional aircraft.{67} As discussed above, terms beyond the 10-year maximum constitute "positive evidence" of a benefit, within the meaning of Article 1.1(b) of the SCM Agreement.

78. Second, Canada's 6 July response to Question 11 from the Panel, and Exhibits Cda-37 through Cda-41, demonstrate that EDC financial contributions were granted on terms more favourable than those available on the market. For example, the [ ] term revealed in Exhibit Cda-38 exceeds the OECD Arrangement's 10-year maximum for regional aircraft, and the financing is based on a floating rate, LIBOR, thereby making the transaction ineligible for the safe haven of item (k). Moreover, the margin added to LIBOR, [] for a borrower that Exhibit Cda-39 reveals is rated, by Canada's own "LA Encore" system, as [], is below market by any reasonable definition.

IV. CANADIAN SUPPORT FOR THE AIR WISCONSIN TRANSACTION CONSTITUTES PROHIBITED EXPORT SUBSIDIES

79. Canada's actions in the Air Wisconsin transaction, announced on 10 January 2001 by Canadian Industry Minister Brian Tobin, was the precipitating event that led Brazil to request this Panel.{68} Only a month before, in December 2000, Brazil had amended its export credit measure, PROEX, to bring it into compliance with WTO requirements. Canada totally disregarded the changes made by Brazil. More importantly, Brazil never provided or offered, formally or informally, any support of any kind whatsoever to Embraer in the Air Wisconsin transaction – and from the date of

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{66} *Id*.

{67} Dominic Jones, "Ready, Steady . . . ," *Air Finance Journal*, January 2000, pg. 48 (EDC financing was for a period of 12 years) (Exhibit Bra-34).

{68} Transcript of Press Conference of Industry Minister Brian Tobin, 10 January 2001 ("Tobin Press Conference") (Exhibit Bra-21).

Minister Tobin's press conference until now, Canada has produced no evidence to the contrary. Still, Minister Tobin, in that press conference, announced that Canada was simply matching "Brazil's" support to Embraer.

80. Minister Tobin had no factual basis for that very regrettable and very untrue statement. Other Canadian officials, since January, have repeatedly, just as inaccurately and imprudently, repeated that statement. Neither Minister Tobin nor any official of the Canadian Government ever asked Brazil whether in fact Brazil was supporting Embraer in that transaction. Thus, while the Air Wisconsin transaction is far from the only transaction with which this dispute is concerned, it is a very important one. And the record shows that it was Canada, not Brazil, that supported the Air Wisconsin transaction with export subsidies that are prohibited by the WTO.

81. Canada provided support for the Air Wisconsin transaction through a Canada Account loan and an IQ guarantee. Minister Tobin best summarized the support provided to Bombardier during his 10 January 2001 press conference, where he stated that Canada was "using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[69]

82. Although Minister Tobin repeatedly stated during his 10 January 2001 press conference that the use of Canada Account to match competing, below-market offers was not a general practice, it appears that it is becoming so. Just this week, on 9 July 2001, Bombardier announced a $1.7 billion, 75-aircraft sale to Northwest. Minister Tobin and International Trade Minister Pierre Pettigrew announced that the Canadian Government will "match the financing terms that Brazil is offering Northwest Airlines."[70] Minister Pettigrew described the support as "concessionary."[71] Even though Bombardier has already won the contract, Canada has also pledged to double its support if in the future Northwest exercises an option to purchase an additional 75 aircraft.[72]

83. The Air Wisconsin transaction is a perfect illustration of the manner in which the three programs challenged by Brazil in this case are inconsistent "as such" with Canada's obligations under the SCM Agreement. It also demonstrates the inconsistency of those programs with the SCM Agreement "as applied."

A. Canada Account Support for the Air Wisconsin Transaction

84. Canada raises two alternative defences with respect to its Canada Account support for the Air Wisconsin transaction. If Brazilian government support was involved in Embraer's offer to Air Wisconsin – which it was not – Canada claims that it was only "matching" Brazilian support, and that it is therefore entitled to the "safe haven" of item (k). In that case, Canada acknowledges that it confers a "benefit," within the meaning of Article 1.1(b) of the SCM Agreement. If Brazilian government support was not involved, Canada alternatively claims that it was only matching Embraer's, and thus market, terms. Brazil will address each of these defences in turn.

1. Canada's Defence that Its Offer Was Consistent with the SCM Agreement Because It Matched Brazil's Offer Must Fail

85. Canada's first argument is that in the Air Wisconsin transaction it took recourse to the "matching" provisions of the OECD Arrangement, which maintained "conformity with" the "interest

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[69] Tobin Press Conference, para. 66 (Exhibit Bra-21).

[70] Department of Foreign Affairs and International Trade News Release, 9 July 2001 (Exhibit Bra-58).

[71] "Bombardier wins big jet order; Ottawa gives Northwest cut-rate financing," *The Globe and Mail*, 10 July 2001 (Exhibit Bra-59).

[72] *Id*.

rates provisions" of the Arrangement. Recourse to item (k) is, of course, an affirmative defence. Canada has the burden of establishing entitlement to that defence. In its previous submissions to the Panel, Brazil has already provided three reasons why Canada cannot do so. First, Embraer's offer to Air Wisconsin involved no support from the Brazilian government. Second, Canada did not match Embraer's offer, but rather offered more favourable terms. Third, "matching" does not bring a Member into "conformity with" the "interest rates provisions" of the OECD Arrangement.

(a) Brazil Neither Offered Nor Promised Support for the Air Wisconsin Transaction

86. Canada's justifications for its support for the Air Wisconsin transaction rest on the assumption that it "matched" a competing officially supported offer. As Brazil has previously explained, Canada's justifications fail for two reasons. First, had Canada complied with Article 53 of the OECD Arrangement, which requires a Participant wishing to "match" a non-participant's offer to "make every effort to verify" that the terms and conditions it is intending to match "are officially supported," Canada would have learned that Embraer's offers were for its own account and at its own risk. Embraer did not even request, let alone receive, support of any kind whatsoever from the Government of Brazil or from any other Brazilian government entity.

87. Canada's efforts at verifying Brazilian government participation in the Air Wisconsin fell considerably short of the standard included in Article 53 of the OECD Arrangement. According to Exhibit Cda-1 and paragraph 13 of Canada's First Written Submission, on 20 October 2000, a Bombardier salesperson "learned that Brazil was prepared to finance the sale of regional jets to Air Wisconsin on terms far more favourable than those that Air Wisconsin would have been able to obtain in the commercial marketplace."[73]

88. Between 20 October 2000 and 10 January 2001, when Industry Minister Tobin announced that Canada was "matching" Brazilian support for the Air Wisconsin transaction,[74] Canada did not contact Brazil to verify, in good faith, the accuracy of the information it had received. Canada therefore has not met its burden to show that it "made every effort to verify" that there was indeed Brazilian government support involved in Embraer's offer to Air Wisconsin. Moreover, as Brazil has demonstrated, Embraer in fact neither requested nor received any such support.

(b) Canada Has Failed to Prove That, Even If There Was Government Support by Brazil Offered or Promised to Embraer for the Air Wisconsin Transaction, Canada Matched the Offer

89. Even assuming that Embraer's offer was made with Brazilian government support, Canada must show that it matched that offer. Canada states that it was justified in extending "non-identical matching" to Air Wisconsin.[75] In its response to Question 36 from the panel, Brazil noted that "non-identical" matching does not appear to be available with respect to allegedly non-conforming terms offered by non-participants in the OECD Arrangement such as Brazil. Even if "non-identical" matching were permitted in this case, however, Canada bears the burden of showing that its "non-identical" offer included financing terms that were economically equivalent to Embraer's offer.[76] Canada has not done so.

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[73] The same assertion is made in paragraph 43 of Canada's First Written Submission.

[74] Tobin Press Conference, paras. 7, 15, 20, 27, 74, 126 (Exhibit Bra-21).

[75] Canadian first written submission, footnote 36.

[76] The ordinary meaning of the verb "match" is "be equal to; correspond to, go with, be the match or counterpart of." THE NEW SHORTER OXFORD ENGLISH DICTIONARY (Third Ed., 1993), pg. 1713.

90. As evidence that it merely matched the terms of Embraer's offer, Canada offers a statement by an Air Wisconsin official that Canada's offer was "no more favorable than" Embraer's offer, "viewed in its entirety."[77] A statement by an airline interested in preserving the legality, and thus the viability, of its recently-negotiated deal is of limited use. Apart from the airline official's self-interest, it also appears that Air Wisconsin actually was contractually obligated to make this statement.[78]

91. Moreover, it is significant that the Air Wisconsin official stated that the two offers were equivalent in their "entirety." While matching only extends to the financing terms of an offer, the "entirety" of an offer goes beyond its financing terms. For example, Embraer's offer contained a special element unrelated to financing.[79] Thus, when Canada subsidized to "match" Embraer's offer (assuming Embraer's offer was actually matched) it did not simply match the financing. Instead, it used a subsidy to meet Embraer's offer in its "entirety," which went beyond financing.

92. Canada's argument that it matched Brazil's offer is also curious given its reaction of surprise and disbelief when it saw the terms of Embraer's offer, submitted by Brazil to the Panel on 25 June 2001. Canada stated on numerous occasions during the first meeting of the Panel that it still did not know some of the terms of Embraer's offer, and did not understand others about which it did know. But if Canada did not know or understand some of the key terms of Embraer's offer, how can it claim to have "matched" that offer?

93. It is Canada's burden to show that it actually matched Embraer's offer – term by term, component by component – so that the decisive factor in Air Wisconsin's choice was not the more favourable financing terms offered by Canada but, as Canada asserted at the first meeting of the Panel, the quality of the planes. Canada has not even attempted to do so, and thus has failed in demonstrating its entitlement to an affirmative defence.

(c) Canada Has Failed to Show that "Matching" Is a Practice Covered by the "Safe Haven" of Item (k)

94. Even if Embraer's offer included Brazilian government support, and even if Canada in fact matched that offer, Canada bears the burden of showing that recourse to matching maintains "conformity with" the "interest rates provisions" of the OECD Arrangement." Once again, Canada has failed to do so.

95. In its responses to questions from the Panel, Brazil has affirmatively demonstrated that matching does not bring a Member into conformity with the interest rates provisions of the Arrangement. Rather than repeating those arguments here, Brazil refers the Panel to its detailed response to Question 36 from the Panel.

96. In conclusion, Canada did not "make every effort to verify" that Embraer's offer to Air Wisconsin included Brazilian government support. In fact, Embraer neither sought nor received such support. Even if Embraer's offer had included government support, however, Canada did not merely match that support, even on "non-identical" terms. It in fact provided terms considerably more favourable than those included in Embraer's offer. Finally, even if Canada did match Embraer's offer, recourse to matching does not maintain "conformity with" the "interest rates provisions" of the OECD Arrangement. For all of these reasons, Canada has not established its entitlement to the "safe haven" included in item (k).

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[77] Exhibit Cda-2.

[78] Canadian response to Panel's 20 June 2001 request for information regarding the Air Wisconsin transaction, belatedly submitted 26 June 2001, Attachment (pg. 14) (One []).

[79] *See* Brazil's letter to the Panel of 25 June 2001, containing the description of the terms of the Embraer offer to Air Wisconsin, last paragraph.

2. Canada's Claim that by Offering Terms Equivalent to Embraer's Offer It Offered Market Terms of Financing Must Fail

97. Canada argues that if there was no Brazilian government support for Embraer's offer to Air Wisconsin, Canadian support matching Embraer's offer "would be on terms no more favourable than those available to the recipient in the market."[80] This argument must be rejected for two reasons: first, Canada in fact offered terms more favourable than the terms included in Embraer's offer; and, second, the terms of Canada's official support, even if equivalent to the terms of Embraer's offer, were not terms available to *Bombardier* in the market.

(a) Canada Cannot Show that the Terms of Its Official Financial Support Are Identical or Equivalent to the Financing Terms Included in Embraer's Offer

98. According to Canada, if Embraer did not receive support from the Brazilian government, the terms of its offer reflected the market. By matching Embraer's offer, Canada asserts, it did not provide Air Wisconsin with terms more favourable than those available in the market. According to Canada, no "benefit," within the meaning of Article 1.1(b) of the SCM Agreement, was thereby conferred. Even assuming, however, that Embraer's offer reflected the market for financing terms – an assumption that Brazil will demonstrate is not the case – Canada did not "match" the terms of financing included in Embraer's offer.

99. At the outset, Brazil notes the remarkable nature of Canada's claim. Support for the Air Wisconsin transaction was provided *via* EDC's vehicle for "official support" – the Canada Account. EDC resorts to the Canada Account only when it must go below the standard enumerated in paragraph 67 of its First Written Submission – in other words, when it is providing a "benefit" with terms better than "what the relevant borrower has recently paid in the market for similar terms and with similar security."

100. In the Air Wisconsin transaction, however, Canada claims that even "official support" granted *via* EDC's Canada Account does not always confer a benefit, and is not always subject to the OECD Arrangement. If "official support" is used to match an offer that also entails "official support," Canada considers itself constrained by the terms of the OECD Arrangement, and dependent upon the "safe haven" of item (k). Paradoxically, if "official support" is used to match an offer that does not similarly entail "official support," there are no OECD constraints on Canada's ability to use its "official support" vehicle and that vehicle's extraordinarily low cost of funds to support Bombardier in competition with a purely private entity acting without government support.

101. In effect, Canada's argument is that EDC is subject to the constraints of the OECD Arrangement – and thus the provisions of the SCM Agreement – only when Canada decides it is. Moreover, other Members have no way of knowing whether, in a given situation, Canada considers EDC to be bound by the Arrangement and must, it seems, await Canada's subsequent explanations to determine with which, if any, rules of the Arrangement (and thus of the second paragraph of item (k)) EDC felt constrained to comply in any given situation. The flexibility EDC maintains to choose, and change, the constraints to which its support is subject, raises the question why Canada even participated in the OECD Arrangement at all.

102. In any event, Canada has failed to demonstrate that it matched the terms of Embraer's offer. Its only claim, as discussed above, is that Embraer's and Canada's offers were equivalent in their

[80] Canadian Oral Statement, para. 16. *See also* Canadian Response to Question 10 from the Panel, para. 1.

"entirety."[81] Whether Canada's offer was equivalent to Embraer's offer in its "entirety" is irrelevant, however. The offers may have been equivalent in their "entirety," at least in the judgment of a potential purchaser, because, for example, the more favourable terms of financing in one offer may have compensated better pricing or other incentives in the other. What Canada must do is demonstrate that the *financing terms* of the two offers were equivalent.

103. Canada cannot do so. As discussed above and in Brazil's 6 July response to Question 34 from the Panel, Embraer's offer contained a special element unrelated to financing,[82] and when Canada "matched" Embraer's offer in its "entirety," it did not simply match the financing terms of that offer. It used a subsidy to meet Embraer's offer in its "entirety," which extended beyond the financing of that offer.

104. Finally, the combination of a loan from EDC's Canada Account and an equity guarantee from IQ could not have been on terms comparable to the terms of Embraer's offer. By offering loan and equity guarantees, Canada transfers its high credit rating to the borrower and the equity investors and thus *always* confers a benefit. As Minister Tobin specifically acknowledged in his press conference, Canada was "using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[83]

(b) The Terms of Embraer's Offer Do Not Constitute the "Market"

105. Canada asserts that if it matched the terms of an Embraer offer to Air Wisconsin that involved no Brazilian government support, it did not confer a benefit, since it merely offered "terms no more favourable than those available to the recipient in the market."[84] Canada provides no support for its assertion that the terms Embraer offered are indeed no more favourable than those available in the market. Moreover, Canada fails to acknowledge that the "market" cannot be established solely with reference to an offer, not accepted, made by a single company with respect to a single transaction.

106. As Brazil discussed in greater detail in its 6 July response to Question 31 from the Panel, Embraer could have offered *below-market* terms for a variety of reasons. It may have wanted to win market share. It may have been willing to forego profits (or even suffer losses) to secure a launch customer, or to win a new customer in the expectation that future business would follow. It may, moreover, have arranged financing through private investors, or it may have self-financed. One can speculate on what Embraer's marketing strategy may have been. The point, however, is that Canada cannot show that Embraer's offer is equivalent to the "market."

(c) The Terms of Embraer's Offer Are Irrelevant; the Official Support Extended by Canada Confers a Benefit Because Its Terms Are Better than the Terms of Financing Bombardier Can Find in the Market

107. Finally, whether matching an unassisted Embraer offer resulted in terms "no more favourable than those available to the recipient in the market" depends upon who the recipient is. A benefit may be conferred upon Air Wisconsin by a financial contribution from Canada Account. Equally, however, a benefit may be conferred upon *Bombardier* by that same financial contribution. When it offered Canada Account support to Air Wisconsin, Canada "thereby conferred" a benefit upon Bombardier, by allowing Bombardier to make an offer to Air Wisconsin with terms of financing that Bombardier would otherwise be unable to offer.

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[81] *See* Exhibit Cda-2.

[82] *See* Brazil's letter to the Panel of 25 June 2001, containing the description of the terms of the Embraer offer to Air Wisconsin, last paragraph. *See also* the final two pages of Exhibit Bra-56.

[83] Tobin Press Conference, para. 20 (Exhibit Bra-21).

[84] Canadian Oral Statement, para. 16.

108. This was made clear by Minister Tobin during his press conference. He stated: "What happens in the case of Embraer is that they were able to secure preferential, below commercial rates of interest in providing financing on the sale of aircraft, and that is something that Bombardier cannot do on its own."[85] Minister Tobin emphasized further: "What we're doing is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[86] Minister Tobin has, in fact, defined very precisely why Canada has conferred a benefit with its support for the Air Wisconsin transaction – because Canada provided Bombardier financing on terms that Bombardier could not otherwise obtain in the commercial market.

109. Canada's involvement in the Air Wisconsin transaction constitutes a prohibited export subsidy that does not fall within the "safe haven" of item (k). What Canada essentially told Bombardier was, "Go as low as you need to win the sale, we will do whatever is necessary to support you." No market lender would make such a statement to an unrelated vendor. Only an ECA would make such a statement, to a national vendor. By reducing the cost of the financing component of the Bombardier package to Air Wisconsin, Canada permitted Bombardier to avoid responding to Embraer's price competition to the degree that it would have to have done in order to match the overall cost (price plus financing) offered by Embraer. In so doing, Canada conferred a prohibited export subsidy on Bombardier as well as Air Wisconsin.

B. IQ Support for the Air Wisconsin Transaction

110. In footnote 37 of its First Written Submission, and again in its 26 June response to the Panel's 20 June request for information regarding the Air Wisconsin transaction, Canada discusses the provision by IQ of a [] equity guarantee to Air Wisconsin. IQ spokesman Jean Cyr stated that the Québec Government increased the IQ funds available to support Bombardier sales after Bombardier, on 20 December 2000, "'came to us and said they were negotiating this big deal with Air Wisconsin that would require'" more than what was at the time available in an existing IQ program.[87] That same day, the provincial government adopted Decree 1488-2000, which increased the amount available to Bombardier customers to $226 million. Canada has submitted this Decree as Exhibit Cda-36.[88]

111. In Section V below, Brazil discusses why IQ support is contingent in law or in fact on export. Those arguments apply equally to IQ support for the Air Wisconsin transaction. Brazil focuses here on the reasons why the guarantee to Air Wisconsin is a financial contribution and confers a "benefit." This reasoning applies equally to the other loan and equity guarantees that Canada has admitted, in its response to Question 14 from the Panel, have been granted by IQ to support Bombardier's exports of regional aircraft. Those other IQ guarantees are discussed in Section V below.

112. Brazil has earlier explained why government-supplied export loan guarantees are prohibited subsidies. Loan guarantees are *per se* prohibited by item (j) to the Illustrative List of Export Subsidies. Moreover, an IQ loan guarantee, like an EDC loan guarantee, constitutes a financial contribution and confers a benefit by substituting a superior governmental credit rating for a borrower's inferior credit rating. The loan guarantee enables an airline to borrow funds based upon

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[85] Tobin Press Conference, para. 15 (Exhibit Bra-21).

[86] Tobin Press Conference, para. 20 (Exhibit Bra-21).

[87] "Ottawa backs Bombardier: Loan to US firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9).

[88] Décret 1488-2000, 20 décembre 2000, concernant une participation de 226 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc. (Exhibit Cda-36).

the credit rating of the Government of Québec, which is A+ or A2.[89] As Canada has itself stated, when a government guarantee is issued, "the lending bank establishes financing terms in the light of the risk of the . . . Government, not the borrower."[90] The IQ guarantee thus confers a significant benefit, and therefore a subsidy.

113. Equity guarantees are equally prohibited. They, too, are financial contributions that confer benefits and, in the case of IQ, are contingent upon export. Before turning to these points, however, Brazil will discuss Canada's attempt to dismiss IQ equity guarantees as just a version of something available in the market.

114. In its Exhibit Bra-50, Brazil has presented evidence that third-party equity guarantees of the kind involved in these transactions are not commercially available in the market. Canada attempts to deflect this evidence in paragraph 4 of its 6 July response to Question 14 from the Panel, by stating that it is "informed" that "such private sector commercial actors as GE, Rolls-Royce, and Pratt & Whitney have been known to provide such guarantees." So, indeed, they have, but this fact does not contradict Brazil's evidence: that equity guarantees are not available in the market.

115. Each of these firms is a manufacturer of jet engines; indeed, they are the world's three major manufacturers. They supply both Bombardier and Embraer, as well as Airbus and Boeing. Engines are the single most expensive component of an aircraft, usually constituting between 30 and 40 per cent of the total value. These engine manufacturers compete to have their engines used on an aircraft, and have a strong stake in its success. The ERJ 145, for example, uses Rolls-Royce engines, while the CRJ 200 uses GE engines. Because the engine manufacturers are virtual partners with airframe manufacturers, it is not unheard of for engine manufacturers to assist in the marketing and financing of an airplane. When this occurs, however, it involves the overall relationship between the two private companies – the engine manufacturer and the airframe manufacturer – in the sale of a product in which they both have an interest.

Engine manufacturers do not, to Brazil's knowledge, provide equity guarantees, or any other kinds of support, for the sale of aircraft that carry a competitor's engines. They are not market actors in the business of providing guarantees for a profit; they are manufacturers interested in selling the engines they produce. Embraer's evidence remains unrebutted: third party equity guarantees are not available in the market. IQ therefore provides for Canadian exporters something that is not available on the market at any price, and thus is by definition more favorable than the market.

116. Having disposed of this preliminary point, Brazil will now address the status of equity guarantees as subsidies. Equity guarantees are financial contributions in the same sense that loan guarantees are financial contributions. Canada has acknowledged that both IQ equity and loan guarantees are "potential direct transfers of funds or liabilities," and are therefore "financial contributions" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement.[91]

117. In paragraphs 89-91 of its First Written Submission, Brazil discussed the manner in which equity guarantees protect equity investors from risk inherent in regional aircraft transactions. IQ equity guarantees such as that provided to Air Wisconsin confer a benefit by providing a governmental guarantee to equity investors, thus making equity participation more readily available to the transaction. In this case, they substitute Québec's A+ to A2 credit rating for Bombardier's A-

[89] Standard & Poor's, Non-US Local and Regional Government Ratings Since 1975, pg. 7 (Exhibit Bra-60); Moody's Ratings List, Government Bonds and Country Ceilings, pg. 5 (Exhibit Bra-61).

[90] WT/DS46/RW, Annex 1-2 (para. 36) (emphasis added).

[91] Canadian First Written Submission, para. 87.

credit rating.[92] Indeed, even if a governmental credit rating were no better than that of a manufacturer, such as Bombardier, a benefit nonetheless would be conferred on Bombardier because it would remove a potential liability from Bombardier's books, thereby enhancing Bombardier's credit rating. The IQ guarantee provided to Air Wisconsin therefore confers a benefit and constitutes a subsidy.

118. Canada has not addressed whether the guarantee to Air Wisconsin carries a fee. Brazil notes that while some of the earlier Québec decrees establishing and funding the IQ guarantee program for Bombardier customers indeed require IQ to charge annual fees,[93] Decree 1488-2000, which as discussed above was adopted to facilitate the Air Wisconsin transaction, eliminates the requirement of a fee altogether.[94]

V. INVESTISSEMENT QUÉBEC SUPPORT FOR THE CANADIAN REGIONAL AIRCRAFT INDUSTRY CONSTITUTES PROHIBITED EXPORT SUBSIDIES

A. Investissement Québec Constitutes a Prohibited Subsidy As Such

119. As Brazil noted in its First Written Submission,[95] IQ provides a range of support to purchasers of Canadian regional aircraft. These include loan guarantees, first loss deficiency guarantees to equity investors, and "any other form of intervention provided for in . . . [Investissement Québec's] business plan."[96] Canada has acknowledged that "the provision of such guarantees by a government or public body constitutes [a direct or] potential direct transfer of funds or liabilities within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement and would therefore be a 'financial contribution.'"[97]

120. Canada argues that IQ guarantees are not susceptible to challenge "as such" because "[n]othing in the Investissement Québec Act mandates it to provide financing at all."[98] This is inaccurate. The series of Québec government decrees provided by Canada in its 6 July response to Question 9 from the Panel clarify that IQ guarantees to regional aircraft purchasers were issued pursuant to Article 28 of *An Act Respecting Investissment-Québec and Garantie-Québec* ("IQ Act").[99] Article 28 states that:

> The Government may, where a project is of major economic significance for Québec, *mandate* [IQ] to grant and administer the assistance determined by the Government to facilitate the realization of the project. The mandate may authorize the agency to fix the terms and conditions of the assistance.[100]

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[92] Standard & Poor's rating, as reported in "S&P affirms Bombardier rating," *The Globe and Mail*, 9 August 2000 (Exhibit Bra-63).

[93] See Décret 1187-98, 16 septembre 1998, concernant une participation de 150 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc., at (b) (Exhibit Cda-35). See also Décret 879-97, 2 juillet 1997, concernant la participation de la Société de développement industriel du Québec relativement à la vente d'avions par Bombardier Inc., at quatrième alinéa, (b) (Exhibit Cda-34).

[94] *See* Exhibit Cda-36.

[95] Brazilian First Written Submission, paras. 84-86.

[96] An Act Respecting Investissement-Québec and Garantie-Québec ("IQ Act"), Art. 25 (Exhibit Bra 18).

[97] Canadian First Written Submission, para. 87.

[98] Canadian First Written Submission, para. 42.

[99] Décret 1488-2000, 20 décembre 2000, concernant une participation de 226 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc. (Exhibit Cda-36); Décret 1187-98, 16 septembre 1998, concernant une participation de 150 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc. (Exhibit Cda-35).

[100] IQ Act, Art. 28 (Exhibit Bra-18).

121. Thus, when Article 28 serves as the legal basis for a decree under which IQ guarantees are provided in regional aircraft transactions, the Government of Québec "mandates" IQ to provide the assistance described in the decree.

122. Canada also argues that IQ guarantees are not susceptible to challenge "as such" because IQ is not required, with the provision of those guarantees, to confer a "benefit," within the meaning of Article 1.1(b) of the SCM Agreement.[101] This is likely a reference to the statement in Article 28 of the IQ Act that IQ may itself "fix the terms and conditions of the assistance." Thus, Canada appears to argue that even if Article 28, which serves as the legal basis for the decrees under which IQ guarantees are provided, "mandates" the provision of those guarantees, it does not mandate that the terms of those guarantees confer a "benefit," or in other words "terms more favourable than those available to the recipient in the market."[102]

123. This also is inaccurate. Loan guarantees are *per se* prohibited by item (j) to the Illustrative List of Export Subsidies. Moreover, Brazil has noted that any time a government issues a loan guarantee to a purchaser, the guarantee enables the recipient to borrow funds based upon the credit rating of the Government of Québec, which, as noted above, is A+ or A2. Since this is invariably superior to the credit rating of virtually any commercial purchaser, particularly one buying regional aircraft, loan guarantees issued by IQ thus confer a significant benefit by allowing firms buying Bombardier aircraft to borrow funds at a more favorable rate than would otherwise be available to them on the market. IQ does not maintain any discretion to forego this benefit; it is automatically dictated by the different credit ratings of the purchaser and the Government of Québec. Thus, IQ loan guarantees confer benefits, and constitute subsidies, "as such."

124. As discussed above with respect to the Air Wisconsin transaction, IQ equity guarantees similarly confer a benefit, by providing a governmental guarantee to equity investors, and thus making equity participation more readily available to the transaction. An IQ equity guarantee substitutes Québec's A+ to A2 credit rating for Bombardier's A- credit rating.[103] Indeed, even if a governmental credit rating were no better than that of a manufacturer, such as Bombardier, a benefit nonetheless would be conferred on Bombardier because it would remove a potential liability from Bombardier's books, thereby enhancing Bombardier's credit rating. Again, IQ does not maintain any discretion to forego this benefit; it is a function of the higher credit rating of the Government of Québec. Thus, IQ equity guarantees confer benefits, and constitute subsidies, "as such."

125. In its defence, Canada asserts that IQ charges fees for its guarantees.[104] While some of the decrees included in Canada's 6 July response to Question 9 from the Panel indeed require, as a condition on the grant of a guarantee, that IQ charge annual fees of not less than 0.5 per cent,[105] the most recent decree, as noted above, eliminates this condition altogether.[106] In paragraph 7 of its 6 July response to Question 14 from the Panel, Canada states that in exchange for its guarantee, "Quebec receives both an up-front fee of [] basis points . . . as well as an annual fee equivalent to [] basis points

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[101] Canadian First Written Submission, para. 42 ("Nothing mandates [IQ] to provide financing that would confer a 'benefit' within the meaning of Article 1 of the SCM Agreement.").

[102] WT/DS70/AB/R, para. 158.

[103] Standard & Poor's rating, as reported in "S&P affirms Bombardier rating," *The Globe and Mail*, 9 August 2000 (Exhibit Bra-63).

[104] Canadian First Written Submission, para. 91; Canadian 6 July response to Question 14 from the Panel, para. 7.

[105] See Décret 1187-98, 16 septembre 1998, concernant une participation de 150 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc., at (b) (Exhibit Cda-35). See also Décret 879-97, 2 juillet 1997, concernant la participation de la Société de développement industriel du Québec relativement à la vente d'avions par Bombardier Inc., at quatrième alinéa, (b) (Exhibit Cda-34).

[106] Décret 1488-2000, 20 décembre 2000, concernant une participation de 226 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc. (Exhibit Cda-36).

. . . " However, and as Brazil also noted with respect to EDC guarantees, Canada makes no effort, in asserting its defence, to demonstrate that these fees are commensurate with those charged by commercial guarantors with A+ or A2 credit ratings to firms wishing to enjoy the benefits of those guarantors' A+ or A2 ratings.

126. Even if Canada could show that purchasers of regional aircraft enjoy the same credit rating as the Government of Québec, Article 14(c) of the SCM Agreement provides that a guarantee will still confer a benefit as long as "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."[107] Whenever a regional aircraft purchaser – which inevitably has a lower credit rating than the Government of Québec – receives an IQ loan guarantee, there will be, in the terms of Article 14(c), a difference between the amount it pays on a loan and the amount it would pay on the loan absent the IQ guarantee. If not the letter, then the logic of Article 14(c) could similarly be applied to equity guarantees.

127. Thus, IQ is required to issue guarantees, and those guarantees will always confer benefits. IQ guarantees therefore constitute subsidies within the meaning of Article 1.1 of the SCM Agreement.

128. With respect to export contingency, in paragraphs 98-99 of its First Written Submission, Brazil demonstrated that IQ support for transactions involving the sale of goods such as aircraft are *de jure* contingent on the export of those goods outside of Québec. Canada claims that the IQ decrees relied upon by Brazil in those paragraphs of its submission do not apply to aircraft sales financing.[108] Those decrees most certainly do, however, apply to support for transactions involving the sale of goods. Regional aircraft are goods. The decrees thus require that every time IQ supports the sale of aircraft, it does so on the condition that the recipient export those aircraft outside of Québec. Moreover, Canada overlooks Brazil's citation to Article 25 of the IQ Act, which provides that IQ "shall participate in the growth of enterprises, in particular by facilitating research and development and export activities."[109]

129. Canada argues that a requirement to export outside of Québec is not equivalent to a requirement to export outside of Canada.[110] In its Oral Statement for the first meeting of the Panel, Brazil demonstrated that a requirement that recipients of IQ support export out of Québec is tantamount to a requirement that they export out of Canada.[111] Brazil noted that Canada's designation of part of its territory as ineligible for IQ support has the necessary effect of increasing the incentive of producers to export and the likelihood that they will do so because all of their home territory is not available to them. Canada seems to imply that, because nine of its 10 provinces remain eligible markets for the subsidized goods, this is somehow close enough to 10 out of 10. Under Canada's theory, IQ support would not be considered contingent on export as long as Canada made, say, Prince Edward Island eligible for IQ support for regional aircraft. This would subvert the export subsidy disciplines included in the SCM Agreement. If eligibility of part, but not all, of a Member's territory for a subsidy is enough to remove export contingency, many small, partial domestic eligibility designations are likely to follow rapidly. IQ guarantees are, therefore, *de jure* contingent on export.

B. Investissement Québec constitutes a prohibited subsidy as applied

1. Preliminary issues

[107] The Appellate Body looked to Article 14 of the SCM Agreement as "relevant context" for the interpretation of the "benefit" requirement in Article 1.1(b) of the Agreement. WT/DS70/AB/R, para. 155.

[108] Canadian First Written Submission, para. 93.

[109] IQ Act, Art. 25 (Exhibit Bra-18).

[110] Canadian First Written Submission, para. 94.

[111] Brazilian Oral Statement, paras. 56-62.

130. In paragraphs 90-91 of its First Written Submission, Brazil discussed the provision of IQ guarantees to several Bombardier customers, including Mesa, Atlantic Southeast, Midway and Northwest Airlines.[112] The Panel noted, in Question 14 to Canada, that Canada had not denied IQ's involvement in those transactions.

131. While in its response to Question 14 Canada lists several Bombardier customers to which IQ provided guarantees, in paragraph 1 of its response, it states that IQ was not involved in the Atlantic Southeast or Northwest transactions. However, Canada does not deny that IQ's direct predecessor, the Société de développement industriel du Québec ("SDI"), was involved in the Atlantic Southeast and Northwest transactions. As discussed in paragraph 82 of Brazil's First Written Submission, in March 1998, IQ was effectively substituted for SDI, and took over SDI's operations in their entirety.[113] SDI in fact administered two of the Québec decrees (concerning guarantees for Bombardier customers) provided by Canada in response to Question 9 from the Panel.[114] Brazil requests that the Panel inquire of Canada whether SDI was involved in the Atlantic Southeast and Northwest transactions discussed in paragraph 91 of Brazil's First Written Submission.

132. As a matter of simple math, the list of transactions included in Canada's response to Question 14 cannot be complete. IQ spokesman Jean Cyr stated that at the time of the Air Wisconsin transaction, $300 million of a $450 million IQ fund established in 1996 to support Bombardier transactions had been used (additional funding was added to meet Bombardier's needs for the Air Wisconsin transaction).[115] Canada's list includes [] aircraft, each of which received a maximum [] per cent equity guarantee. Of those [ ] aircraft, [] received an additional [] per cent loan guarantee. If the average price of a Bombardier aircraft is $[] million, an equity guarantee of [] per cent on [] aircraft would equal $[] million. A loan guarantee of [] per cent on [] aircraft would be an additional $[] million, for a total of $[] million in committed funds. Mr. Cyr, however, stated that $300 million had been used. Canada has not accounted for this difference of nearly $[] million. Brazil requests that the Panel ask Canada to do so.

133. Canada lists several Bombardier customers to which IQ provided guarantees; namely, Mesa, Midway, Air Littoral, Atlantic Coast Airlines and Air Nostrum. Brazil notes, however, that Canada has not provided the information specifically requested by the Panel with respect to those transactions. Question 14 asks Canada to provide "all documentation regarding the review of these transactions by IQ," as well as "the credit ratings of the relevant airlines at the time of these transactions." Despite this specific request from the Panel, Canada has provided no documentation whatsoever regarding the review of these transactions. Nor has it provided the credit ratings of the customers.

134. This information is highly relevant to the Panel's determination whether the guarantees provided by IQ confer "benefits," within the meaning of Article 1.1(b) of the SCM Agreement. Brazil has noted that IQ guarantees provide benefits by making available the superior credit rating of the Government of Québec. Québec's superior credit rating allows firms with lower ratings to obtain

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[112] IQ guarantee support was also provided to Air Wisconsin. *See* Brazilian First Written Submission, para. 85.

[113] *See also* Article 1 of the *Order in Council respective responsibilities of Investissement-Québec and Garantie-Québec*, which provides that "[i]n any regulation, contract, certificate or other document, regardless of its nature or form, a reference to the Société de développement industriel du Québec is a reference to Investissement-Québec where it relates to," for example, the performance of SDI's mandate under Article 7 of its authorizing legislation. (Exhibit Bra-62). Before IQ took over SDI's operations in March 1998, Article 7 was cited as the legal basis for the Québec decrees regarding guarantees for Bombardier customers. *See* Exhibits Cda-33 and Cda-34.

[114] Exhibits Cda-33 and Cda-34.

[115] "Ottawa backs Bombardier: Loan to US firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9).

equity or borrow funds on terms better than would otherwise be available to them on the market. Canada has failed to provide the credit ratings for the customers listed in its response to Question 14. Brazil therefore requests that the Panel adopt adverse inferences, and presume that the information, if provided, would have demonstrated that the credit ratings of these customers were at the time of the transactions indeed lower than the credit rating of the Government of Québec.

135. Canada has also failed to provide *any*, let alone *all* "documentation regarding the review of these transactions by IQ," as specifically requested by the Panel. The documentation requested by the Panel undoubtedly would have shed light on whether IQ guarantees conferred benefits upon those customers (or upon Bombardier). That documentation would also have provided further information about any conditions attached to the receipt of the IQ support, such as a condition that the aircraft be exported.

136. For these reasons, Brazil requests that the Panel adopt adverse inferences, and presume that the documentation, if provided, would have demonstrated that the IQ guarantees conferred benefits and were contingent on export.

137. Canada has also not adequately fulfilled the Panel's request, in Question 17, to provide "regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of IQ support to the regional aircraft industry." In the first place, Exhibit Cda-51 concerns SDI, rather than IQ. Brazil notes that when IQ took over from SDI in 1998, the Québec decrees concerning the provision of guarantees to Bombardier customers were updated.[116] Brazil suspects that like the decrees in Exhibits Cda-35 and Cda-36, there exists a more recent version of the "critères d'évaluation" referring to IQ and including any modified factors, and requests that the Panel seek any such documents from Canada.

138. More importantly, the general "critères d'évaluation" included in Exhibit Cda-51 do not fulfil the Panel's request for regulations, guidelines, policies, etc. "concerning the fixing of the terms and conditions of IQ support to the regional aircraft industry." Exhibit Cda-51 does not speak to the fixing of terms and conditions at all, let alone terms and conditions with respect to IQ support for regional aircraft transactions. Surely some guidelines exist. Brazil requests that the Panel once again seek this documentary evidence from Canada.

2. IQ Guarantees As Applied in the Transactions Cited by Canada Constitute Prohibited Export Subsidies

139. As noted above, in its 6 July response to Question 14 from the Panel, Canada stated that five Bombardier customers have received IQ equity guarantees. One of those customers also received an IQ loan guarantee.

140. Brazil has separately addressed the IQ guarantee to a sixth customer, Air Wisconsin, in Section IV of this submission. Although Canada does not include the IQ guarantee to Air Wisconsin in its reply to Question 14, it acknowledged that guarantee in footnote 37 of its First Written Submission.

141. Canada has acknowledged that IQ equity and loan guarantees, as "potential direct transfers of funds or liabilities," are "financial contributions."[117] Moreover, Brazil has discussed above how such guarantees confer a "benefit" by making available Québec's higher credit rating to help secure debt or equity on terms better than would be available on the market in the absence of the guarantees.

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[116] *Compare* Exhibits Cda-33 and Cda-34 (which are dated 1996 and 1997, respectively, and refer to SDI) *with* Exhibits Cda-35 and Cda-36 (which are dated 1998 and 2000, respectively, and refer to IQ).

[117] Canadian First Written Submission, para. 87.

142. In its defence, and although it has provided no documentary proof, Canada claims that IQ charges fees for these guarantees.[118] Canada has not established, however, that these fees are commensurate with those charged by commercial guarantors with A+ or A2 credit ratings to firms wishing to enjoy the benefits of those guarantors' A+ or A2 ratings.

143. Canada also claims that []. [] might mitigate IQ's exposure, it does not mitigate the benefit conferred by the IQ guarantee on the recipient of that guarantee. Whether IQ manages to collect something from []. To whatever degree IQ participates, it contributes to the comparative attractiveness of Bombardier's offer.

144. In any event, it appears that the [].

145. Brazil refers to the Québec government decrees provided by Canada in response to Question 9 from the Panel. Those decrees, provided as Exhibits Cda-33 through Cda-36, establish the SDI/IQ guarantee program under which the guarantees discussed in Canada's response to Question 14 were granted. The 1996 decree provided as Exhibit Cda-33, in the preamble section at page 4303 (and in the operative section at page 4204), calls for the establishment of a company, the equity of which will be wholly-owned by SDI. The sole purpose of this company is to invest in a newly-established "société commerciale," which in subsequent decrees is identified as CQC.[119]

146. The 1996 decree also states that the société commerciale is to be capitalized with equal contributions from Bombardier and the company wholly-owned by SDI. Each is to contribute $100,000 and a sum equal to 10 per cent of the net price of each Bombardier plane that receives an SDI/IQ guarantee.[120] The 1996 decree expressly states that this capital is to be used to [] any guarantees provided to Bombardier customers by SDI/IQ.[121] Thus, even if [] to IQ guarantees were relevant to whether the IQ guarantees conferred a benefit on the recipient, it appears that the [] are made by CQC, an entity that receives half of its funding from IQ itself.

147. In its response to Question 14, Canada also notes that all IQ guarantees have been provided for terms exceeding the 10-year maximum included in the OECD Arrangement (for regional aircraft). As discussed in paragraphs 50-54 of Brazil's First Written Submission, terms beyond the 10-year maximum constitute "positive evidence" of a benefit, within the meaning of Article 1.1(b) of the SCM Agreement.

148. Finally, with respect to *de jure* export contingency, Brazil refers the Panel to the arguments made above regarding IQ "as such." Those arguments apply equally to the IQ guarantees in the transactions cited by Canada in its response to Question 14.

149. Those IQ guarantees are also *de facto* contingent on export. As noted by the Panel in *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, a Member's awareness that its domestic market is too small to absorb domestic production of a subsidized product indicates the subsidy is granted on the condition that it be exported.[122] Canada's 6 July responses to

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[118] Canadian 6 July response to Question 14 from the Panel, para. 7.

[119] Exhibit Cda-36, at point (a) of the operative section; Exhibit Cda-35, at point (a) of the operative section.

[120] The contributions are capped at $24 million.

[121] Exhibit Cda-33, at pg. 4203 ("[L]e capital social [de la société commerciale] sera destiné à contre-garantie des garanties ou des contre-garanties émises par la SDI en faveur d'acheteurs d'avions fabriqués par BOMBARDIER INC. (ou en faveur d'entités ou fiducies intermédiaires à but unique formées au pays ou à l'étranger) . . .").

[122] WT/DS126/R (Adopted 16 June 1999), para. 9.67.

the Panel's questions illustrate its awareness that its domestic market cannot, and as a matter of historical fact has not, supported Bombardier's production of regional aircraft. Canada notes that 96.4 per cent of Bombardier's regional aircraft have been sold outside of Canada,[123] and that 100 per cent of the regional aircraft transactions receiving IQ support have been for export outside of Canada.[124] IQ guarantees are, therefore, also *de facto* contingent on export.

150. Brazil also notes that Canada's failure to comply with the Panel's request in Question 14 for "all documentation regarding the review of these transactions by IQ" makes it difficult for the Panel and Brazil to determine whether the IQ guarantees were in fact conditioned on export. Brazil reiterates its request that the Panel adopt adverse inferences, and presume that the documentation withheld by Canada would establish that the IQ guarantees were contingent on export, within the meaning of Article 3.1(a) of the SCM Agreement.

VI. COMMENTS ON CANADA'S RESPONSES TO QUESTIONS BY THE PANEL

151. Brazil received Canada's responses to the Panel's questions on Friday, 6 July 2001, but because of logistical difficulties faced by Canada, did not receive Canada's exhibits to its responses at the Brazilian Mission in Geneva until Tuesday, 10 July 2001. Accordingly, Brazil has not had adequate time to review those responses fully, and will have additional comments in its statement at the second meeting of the Panel later in greater detail on Canada's answers. For the moment, Brazil has commented on some of Canada's responses throughout this submission, and also adds the following brief comments.

152. Canada's definition of the "market" in response to question 4(b) appears inconsistent with its justification of its matching Embraer's offer to Air Wisconsin in question 10. In response to question 4(b), Canada states that the market "includes banks, other commercial financial institutions and the public bond market, but does not include export credit agencies." This is consistent with other statements of Canada's which defined the market as what the borrower has recently paid in the market for similar terms and security. Canada has also repeatedly stated that the appropriate financing rate for borrowing airlines must be determined by reference to the airline's credit rating rather than the terms of particular transactions.[125] In response to question 10, however, Canada takes the position that a single offer by Embraer is, by itself, the "market" apparently regardless of what the "banks, other commercial financial institutions and the public bond market" listed in question 4 might do. Canada fails to acknowledge that Embraer's offer to Air Wisconsin may itself have been below the "market." Canada's definition of the "market" in question 4, in contrast, is consistent with Minister Tobin's assertion, noted by the Panel in question 10 and to which Canada does not directly respond, that Canada's Air Wisconsin transaction was "a better rate than one would normally get on a commercial lending basis."

153. In question 23, the Panel asked Canada to identify how many transactions involving the sale of Bombardier aircraft since 1995 have been "financed in the commercial market, i.e. without any . . . form of government assistance." In response, Canada states that "[]% of Bombardier's order book was financed in the commercial market." Canada's answer is not clear, however, in that Canada has

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[123] Canadian 6 July response to Question 20 from the Panel. Although Canada does not provide data to support its claim, a good portion of the 3.6 per cent domestic sale figure involved deliveries to Air Canada. The sale to Air Canada, however, was described by former EDC President Paul Labbé as an export sale. To justify the receipt of support from EDC – the *Export* Development Corporation – the Air Canada sale was made through an SPC established in the United States. The aircraft were in turn provided to Air Canada under a lease arrangement with the SPC, but since they were sold *via* a US entity, they qualified for treatment as an export transaction within EDC's mandate. WT/DS70/R, para. 6.112.

[124] Canadian 6 July response to Question 19 from the Panel.

[125] *See*, *e.g.*, WT/DS46/RW, Annex 1-3, Oral Statement of Canada, para. 79.

previously defined the "commercial market" to include Canadian government support provided through so-called "market window" operations.[126] For this reason, the Panel should seek additional clarification as to how many Bombardier transactions were financed in the commercial market, exclusive of any transactions in which Canadian government entities participated on a "market window" basis.

VII. CONCLUSION

154. For the foregoing reasons, Brazil requests that the Panel conclude that support for the Canadian regional aircraft industry through EDC's Corporate and Canada Accounts, as well as Investissement Québec, constitute prohibited export subsidies both "as such" and "as applied." Pursuant to Article 4.7 of the SCM Agreement, Brazil further requests a recommendation from the Panel that Canada withdraw these subsidies without delay.

[126] *See*, *e.g.*, paragraph 3 of Canada's answer to question 4: "EDC can and does participate in financing arranged by commercial banks on market terms."

ANNEX A-11

RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL PRIOR TO THE SECOND MEETING OF THE PANEL

(26 July 2001)

Canada

40. Please provide the credit ratings for Air Littoral, Atlantic Coast Airlines and Air Nostrum at the time of the transactions referred to in Canada's reply to Question 14 from the Panel.

Brazil considers that the Panel's question should also refer to Midway. Although Canada claims that no "public credit rating" was available for Midway, surely it applied its internal credit rating programme to gauge the risk involved in extending guarantee support valued at [] per cent of an approximately $[] million transaction. If IQ did not know Midway's credit rating, Brazil wonders how Canada can claim that IQ support for Midway is on market terms.

In Brazil's view, the Panel should also ask for additional information regarding how Canada generates the credit ratings for EDC transactions. In its response to the Panel's Question 4, Canada states that it generates internal credit ratings using financial modelling software. However, Canada has provided no information regarding exactly which data is input into its database, and how the database analyses the data. Accordingly, the Panel should ask the following questions:

> **Please explain in detail how the process of generating an internal rating works. Does this process rely solely on quantitative financial data or does it involve some subjective judgment? If non-quantitative factors are considered, please provide these factors and explain how they were considered in the generation of the rating.**
>
> **Please provide copies of all documents from industry sources used to generate credit ratings for the listed transactions.**

41. Please provide the documentation requested in Question 14 from the Panel, particularly in respect of the specific guarantee fees involved, and any [], or explain why such documentation is not available.

In addition, please provide all documentation regarding the review by IQ of the Air Littoral, Atlantic Coast Airlines and Air Nostrum transactions referred to in Canada's response to Question 14 from the Panel.

In Brazil's view, the Panel's question should also include Mesa and Midway. In response to Question 14 from the Panel, Canada stated that IQ provided guarantees to Mesa, Midway, Air Littoral, Atlantic Coast Airlines and Air Nostrum. Canada failed to provide "all documentation regarding the review of" not only the Air Littoral, Atlantic Coast Airlines and Air Nostrum

transactions, *but also the Mesa and Midway transactions*. Accordingly, Brazil asks that the Panel extend its request for documentation to include the latter two transactions.

Brazil also notes that Canada's initial failure to provide documentary information specifically requested by the Panel need not lead to renewed requests by the Panel for that information. As a participant before the Appellate Body in the earlier *Canada – Aircraft* dispute, Canada is well aware of the Panel's authority to adopt adverse inferences in response to a refusal to provide information requested by the Panel. Yet, Canada failed to provide that information. In Brazil's view, Canada's failure justifies the adoption of adverse inferences, as discussed in paragraph 136 of its Second Written Submission.

45. At paras. 74 and 75 of its second written submission, Brazil argues in essence that, for the ASA transaction, "EDC financial contributions were granted on terms more favorable than those available on the market." Please comment.

Brazil notes that in its response to the Panel's Question 11, Canada failed to provide any specific information regarding the benchmarks or credit ratings used for ASA. Instead, Canada states that it was able to impute a shadow investment grade rating for ASA based on the company's financial performance, which it claims to have provided in Exhibit Cda-44. However, Exhibit Cda-44 provides only the company's net accounts receivable days for 1991/1995 and accounts payable days for 1995. The Panel should ascertain whether these were the only financial results considered in establishing ASA's credit rating and, if not, obtain all of the information used to establish that rating.

Finally, Brazil notes that in its response to Panel Question 11, Canada states that although EDC's pricing was [] was [] approved. The Panel should ascertain whether EDC made any such exceptions in any other regional aircraft transactions, and if so obtain details regarding the circumstances of such exceptions.

48. At paras 66 and 67 of its second written submission, Canada states that IQ charges an up-front fee of [] basis points, and an annual fee equivalent to [] basis points on its effective exposure. In addition, Canada asserts that IQ is provided with a []. In its letter of 25 June 2001, which includes details of IQ's participation in the Air Wisconsin transaction, there is no reference to either an annual fee, or to a []. Please explain why IQ's participation in the Air Wisconsin transaction does not appear consistent with the practice set forth in the abovementioned paras 66 and 67.

In Brazil's view, the Panel should also ascertain whether IQ takes its up-front fee of [] basis points and its annual fee of [] basis points only on its effective exposure of [] per cent (its [] per cent guarantee minus a counter guarantee of [] per cent) or on its entire [] per cent guarantee. The Panel should also ascertain whether IQ has taken any equity positions in transactions in which EDC is providing any kind of financing or support.

<u>Brazil</u>

49. In its rebuttal submission (para. 38), Brazil argues that "EDC's Canada Account has fundamentally changed since it was first considered in Canada--Aircraft". Brazil then cites in a footnote the Policy Directive submitted by Canada as Exhibit Cda-16. Please describe the alleged change(s). Does Brazil consider that such change(s) has(ve) any impact on the nature of the Canada Account as such, e.g., mandatory or discretionary legislation?

In paragraphs 29-39 of its 13 July Second Written Submission, Brazil cited documents such as that included in Exhibit Cda-16 under the heading "The Panel is Not Precluded by *Res Judicata* from Addressing Brazil's Claims." Brazil's point was to demonstrate that even if *res judicata* applies

to WTO disputes, it does not apply here. This is because Brazil's failure to establish its "as such" claim in the earlier *Canada – Aircraft* dispute was a failure of *proof*. Brazil's current "as such" claim is based upon proof and argument that was not before the Panel in the earlier *Canada – Aircraft* dispute.

In its 6 July responses to Questions 8 and 9 from the Panel, Canada provided a series of legal instruments regarding the creation, funding, operation and administration of EDC's Canada Account. Those documents are included in Exhibits Cda-15 through Cda-24. Although some of those documents are not dated, the date provided on several of them indicates that they were issued or modified subsequent to the Panel's ruling in *Canada – Aircraft*, which was circulated on 14 April 1999.[1] For example, Exhibit Cda-16 is dated 18 November 1999, and Exhibit Cda-17 is dated 29 December 1999 and 15 November 1999.

Both Exhibit Cda-17 and the Appendix to Exhibit Cda-16 include a "policy guideline" that is relevant to Brazil's "as such" claim. Before the Article 21.5 Panel in *Canada – Aircraft*, Canada stated that under this policy guideline, "future Canada Account transactions will be consistent with Canada's obligations under the SCM Agreement in that they will qualify for the safe haven in the second paragraph of item (k) . . ."[2] Thus, Canada acknowledged that without the policy guideline and the safe haven of item (k), Canada Account support would constitute a prohibited export subsidy.

The Article 21.5 Panel determined that the policy guideline was not sufficient to qualify Canada Account support for the safe haven.[3] By Canada's own admission, without the protection of the safe haven, Canada Account support constitutes a prohibited export subsidy. Thus, it is the *failure* of the policy guideline included in Exhibits Cda-16 and Cda-17 that speaks to the nature of EDC's Canada Account "as such."

Brazil notes, however, that this policy guideline is not the only argument and evidence supporting its "as such" claim against the Canada Account. The Panel will recall that EDC uses the Canada Account only when the terms of its support would not be consistent with "what the relevant borrower has recently paid in the market for similar terms and with similar security," and thus could not be provided through the Corporate Account.[4] Canada Account support is, therefore, apparently not consistent with what Canada deems to be the market, and thus confers a benefit and constitutes a subsidy. Moreover, Brazil has argued to this Panel that Canada Account loan guarantees constitute subsidies "as such," since they enable a recipient to secure funds on terms otherwise only available to a recipient, like the Government of Canada, with a AAA credit rating. Every use of the Canada Account will in these respects necessarily result in a subsidy. Further, Canada's support of Bombardier's sale to Air Wisconsin utilising Canada Account, a violation admitted by Canada, not only is an instance of Canada Account "as applied" but an example of how Canada Account, "as such," operates.

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[1] WT/DS70/R (Adopted as modified by the Appellate Body, 20 August 1999).

[2] *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (Adopted as modified by the Appellate Body 4 August 2000), para. 5.61.

[3] *Id*., para. 5.148. The Article 21.5 Panel was necessarily reviewing compliance of the Canada Account "as such" with the SCM Agreement. Review under Article 21.5 of the DSU is limited to measures taken to comply with the recommendations and rulings of the DSB. Canada Account "as applied" in particular transactions would not be subject to review under Article 21.5.

[4] The standard for EDC Corporate Account support is included in Canada's First Written Submission, dated 18 June 2001, at para. 67.

50. At para. 75 of its second written submission, Brazil refers to the US dollar prime rate, and the CIRR, as of the date of its submission. Why is current data relevant for the purpose of assessing transactions dating from March 1997 and August 1998?

Brazil referred to the U.S. dollar rate and the CIRR as of the date of Brazil's submission simply for illustrative purposes. The main points of paragraph 75 are first, that the CIRR is calculated as 100 basis points above the seven-year U.S. Treasury rate, and that by providing financing at T-bill plus [], Canada's financing was presumptively below the market. More importantly, Canada's financing to ASA does not appear to reflect any risk premium associated with the airline's credit rating. Canada has previously stated that "in financing transactions, the credit risk premium is as important a constituent element of the final interest rate paid by a purchaser as the base to which the premium would be added."[5] Moreover, Canada has previously stated that the applicable risk premia for airlines such as Northwest and US Air are in the range of the 10-year U.S. T-bill plus 250 basis points, and that these airlines "enjoy credit standings significantly better than a number of airlines in the industry. Airlines that are less credit-worthy can face spreads as high as 350 bps."[6] Presumably, a small airline such as ASA would have a higher credit risk than US Air or Northwest. Brazil also notes that the offer provided to ASA (Exhibit Cda-43) states []. This appears to be a further illustration of how this transaction was on below-market terms.

51. Regarding para. 78 of Brazil's rebuttal submission, is financing based on a floating rate, e.g. LIBOR, unavailable in the commercial market? In addition, Brazil argues that "the margin added to LIBOR, a mere [] for a borrower that Exhibit Cda-39 reveals is rated, by Canada's own "LA Encore" system, as [], is below market by any reasonable definition." On what ground can Brazil argue that it is "below market"? In answering this question, please respond to Canada's Rebuttal, para. 40, in particular its argument that "EDC participated in the Kendall transaction, a public offering, on an equal risk-sharing basis with seven commercial banks".

While Brazil is aware of officially-supported floating rate transactions in the large aircraft sector, Brazil is not aware of any floating rate transactions in the regional aircraft sector that are not supported by government export credit agencies (whether or not acting through so-called "market windows"), and therefore cannot state with certainty that such financing is available in the commercial market.

Brazil notes further that floating rate transactions are not protected by the safe haven of item (k) of Annex I to the SCM Agreement. The Article 21.5 Panel in *Canada – Aircraft* stated that:

> [I]t would appear that the safe haven could only be potentially available to those specific kinds of official financing support to which the CIRRs . . . apply, given that these are the only *existing* systems of minimum interest rates under the *Arrangement*. . . . Given that they are expressed solely as fixed interest rates, the CIRRs can only meaningfully be applied to transactions with fixed interest rates. That is, there is simply no practical or meaningful way to apply rules concerning minimum *fixed* interest rates to *floating* rate transactions. Thus, we conclude that only official

[5] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (Adopted as modified by the Appellate Body, 4 August 2000), Annex 1-3, Oral Statement Of Canada, 3 February 2000, para. 79.

[6] WT/DS46/RW, Annex 1-3, Oral Statement Of Canada, 3 February 2000, chart 3 (submitted with Exhibit Cdn-14 to the Canadian Oral Statement) (attached as Exhibit Bra-64).

> financing support at fixed interest rates is subject to minimum interest rates, given that the CIRRs are expressed as, and thus can only apply to, fixed rate transactions.[7]

Brazil notes that Canada has not explained how its LA Encore system generates credit ratings, either by providing the input (the data used to generate the ratings) or the output (the ratings themselves) that this programme generates. The mere fact that Canada uses a computer programme that may also be used by commercial banks establishes nothing about *how* Canada uses that programme, or whether it generates (and Canada then uses) ratings that fully reflect all commercial risks associated with the transaction.

The margin of LIBOR plus [] bps for a borrower rated [] by Canada's programme is [] by Canada's own definitions. Canada has previously stated that LIBOR-based floating rates can be translated into equivalent U.S. T-bill-based fixed rates by adding a "swap spread" of approximately of [] to the LIBOR-based rate.[8] Thus, for example, Canada has stated that "British Airways, which is the best rated non-sovereign airline, obtains rates of LIBOR + 30 to 40 bps for large aircraft deals (an additional 20-30 bps should be added for regional aircraft, even for clients with British Airways' credit rating. This translates to T + 105-120 (+125-150 for regional aircraft)" when the swap spread is added.[9]

Canada has also stated that "[f]or the last nine years, the average yield spread for AAA credits has been approximately the 10-year Treasury Bond rate plus 43 basis points; and *no* airline enjoys such a rating,"[10] and that "in December 1999, a representative sample of airline companies operating in the US market obtained financing at T+110 to 250 basis points,"[11] and finally that the "interest rate payable by a borrower with a particularly poor credit rating may be in excess of T + 350 basis points."[12]

Thus, in Canada's own words, the appropriate spread for the best-rated airline for a regional jet transaction would be either LIBOR + 50-70 bps (floating rate) or T-bill plus 125-150 bps (fixed rate transactions). For a "representative" airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up to T-bill + 250 bps, which, adjusting for the swap spread, translates into a floating rate spread of LIBOR + 170 bps. An airline with a poor credit rating, such as BB, would have a credit rating "in excess of T + 350 bps" – which translates into LIBOR + 270. [][13]

Regarding the terms of the Kendell transaction, Brazil notes that Canada's statement that the transaction was on an "equal risk sharing basis" does not appear to be fully accurate. As a threshold matter, Brazil notes that Canada has not to date provided the actual loan agreement. Instead, Canada has simply provided executive summaries regarding the anticipated terms of the deal. These terms may, of course, have changed significantly before final signature.

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[7] *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW (Adopted as modified by the Appellate Body, 4 August 2000), paras. 5.101-102.

[8] WT/DS46/RW, Annex 1-2, Rebuttal Submission of Canada, 17 January 2000, para. 40, note 24.

[9] WT/DS46/RW, Annex 1-2, Rebuttal Submission Of Canada, 17 January 2000, para. 51, note 26.

[10] WT/DS46/RW, Annex 1-5, Canada's Comments on Brazil's Responses to Questions of the Panel, 17 February 2000, paras. 10-11 (Comment on Brazil's response to Question 9).

[11] *Id.*

[12] *Id.*

[13] Based on the information provided by Canada in its 6 July 2001 response to the Panel's questions, it appears that the Kendell transaction was completed in the months immediately after July 1999. The information provided by Canada in the *Brazil – Aircraft* case regarding swap spreads and credit ratings for various airlines was stated to be current as of December 1999 – very close in time to the date of the Kendell transaction.

In any event, it appears that EDC funded [] per cent of the transaction, with the other [] per cent spread among four other underwriters.[14] While seven banks were originally contemplated as participating in the deal, three of the banks appear to have pulled out.[15] This would suggest that these banks considered the deal to be too unprofitable, or too risky, for their participation.

Several issues regarding the Kendell deal remain unresolved by the information provided by Canada. Would the commercial banks have been willing to finance the entire loan amount of the transaction on their own without the participation of a government export credit agency? Certainly, the larger the amount of the loan, the higher the risk and therefore the higher the interest rate? Was EDC's participation essential, therefore, in order to make the deal work?

Canada submits that two of the other banks "set the terms" of the deal. However, it seems inevitable that those banks did so in the full knowledge that EDC was likely to be the major participant. Thus, the terms that those banks were likely to set were influenced by EDC's participation, to Kendell's and Bombardier's advantage. This is shown by the fact that EDC appeared to be initially willing to finance up to [] per cent of the purchase price of the aircraft, whereas the banks were willing to support only [] per cent of the financing amount.[16] This shows that EDC was willing to participate on terms more generous than the commercial banks.

While it appears clear that the Kendell transaction was on terms more favourable than available in the market, the Panel should nevertheless request that Canada provide the following additional information to the Panel:

Please provide the final, signed financing agreement for the Kendell transaction.

Were any of the participating banks aware of EDC's participation before the terms of the deal were set?

Why did three of the original seven banks decide not to participate in the deal?

Why, in light of EDC's [] per cent participation, does Canada consider the deal to be on an equal risk-sharing basis?

Please provide details regarding any fees received by [] for syndicating the loan.

Did EDC enter into any agreements of any kind with [] or any of the banks involved in this deal that would in any way affect the risk borne by EDC or any of the banks in this deal?

Did EDC and the participating banks participate in *pari passu* with respect to every term and condition of the deal? Were there any differences in the nature and extent of the risk assumed by EDC and the participating banks? Which entity assumed the risk of repossession? Which entity assumed the risk of cancellation of any orders for aircraft?

[14] Exhibit Cda-39.

[15] Canada's answer to Question 11 from the Panel lists seven institutions originally intended to participate (though Canada counts only five), whereas the documents provided in Exhibit Cda-39 (pg. 2) lists four banks participating in addition to EDC.

[16] Exhibit Cda-39 (pg. 3).

The answers to these questions would provide much clearer information regarding EDC's participation in the Kendell transaction, and in particular, whether that participation was on terms that constitute a "benefit."

52. In what respects does Brazil believe that Bombardier's offer cannot qualify as "matching offer" under the OECD Arrangement? In particular, in para. 89 of its second written submission, Brazil argues that "[e]ven if 'non-identical' matching were permitted in this case, however, Canada bears the burden of showing that its 'non-identical' offer included financial terms that were economically equivalent to Embraer's offer." Is it Brazil's view that "economic equivalence" is the test to determine whether an offer can qualify as a valid "matching" under the OECD Arrangement? If yes, please explain why.

Canada's offer cannot qualify as a "matching offer" under the *OECD Arrangement* because it does not comply with specific obligations included in the *Arrangement* with respect to matching.

Most importantly, as Brazil has repeatedly observed, Canada did not fulfil its obligation, under Article 53 of the *Arrangement*, to "make every effort to verify" that terms allegedly not conforming with the *Arrangement* were "officially supported." Had it done so, with a simple request to Brazil, it would have discovered that support from Brazil was neither requested nor granted. Embraer's offer to Air Wisconsin was completely on its own account.

Even if Brazilian support had been involved, Brazil explained in its answer to the Panel's Question 36 that the terms and conditions of Canada's offer to Air Wisconsin are self-evidently not "identical" to the terms of Embraer's offer. The question then is whether Canada may offer terms and conditions that while not actually identical, nevertheless "match" the competing offer in that they result in essentially the same financial terms. As Brazil explained in its answer to Question 36, Article 52 of the *OECD Arrangement* permits such non-identical matching with respect to non-notified, non-conforming terms and conditions offered by another Participant in the *Arrangement*. However, Article 53, which regulates matching of non-conforming terms and conditions offered by a *non-participant*, does *not* envisage non-identical matching. As a legal matter, therefore, Canada would not appear to be permitted under the *Arrangement* to engage in non-identical matching of Embraer's offer to Air Wisconsin.

Therefore, even if recourse to matching did maintain "conformity with" the interest rates provisions of the *Arrangement* – which Brazil and the Article 21.5 Panel in *Canada – Aircraft* believe is not the case – Canada has not complied with the matching requirements as set out in the *Arrangement*.

Brazil reiterates its statement in its Second Written Submission that, if non-identical matching of a non-participant's offer were permitted, Canada would bear the burden of establishing that its non-identical offer "matched" Embraer's offer. Canada is, after all, claiming recourse to the affirmative defence included in the second paragraph of Item (k) to the Illustrative List of Export Subsidies. As the Panel notes, Brazil in its submission stated that Canada would thus have to show that its non-identical offer provided terms that were economically equivalent to Embraer's offer. Brazil does not see the term "economically equivalent" as the sole term of legal art for the standard that the Panel must follow. It is simply the dictionary meaning of the term "match." Brazil believes that the term "economically equivalent" fairly summarises the applicable standard, which is that Canada's non-identical offer, to "match" Embraer's offer, must result in the same or equivalent financial or economic terms. Canada itself states, at paragraph 103 of its Second Written Submission, that "[m]atching, by definition, implies equal or similar attributes." If this were not the case, the result would be undercutting, which Canada confirms at paragraph 102 of its submission is not permitted by the *Arrangement*.

Even assuming, *arguendo*, (i) that Embraer's offer involved "official support" from Brazil, (ii) that Canada complied with the specific requirements regarding matching included in the *OECD Arrangement*, and (iii) that recourse to matching maintains "conformity with" the interest rates provisions of the *Arrangement*, Canada has not established that its offer to Air Wisconsin did not undercut Embraer's offer. Brazil has gone one step further, by explaining in its 6 July response to Question 34 of the Panel, and in paragraphs 89-93 and 102-118 of its Second Written Submission, why the terms of Canada's Air Wisconsin deal were more favourable than any offer made by Embraer, and hence cannot be said to "match" any such offer.

53. Regarding paras. 52 and 125 of its second written submission, is Brazil of the view that EDC and IQ guarantee fees are lower than those charged by commercial guarantors with AAA (for EDC) or with A+ or A2 (for IQ) credit ratings to firms wishing to enjoy the benefits of those guarantors? If yes, please explain why and how. In doing so, please explain how account should be taken of any [].

Canada has simply stated that a fee is charged for the guarantees in question. Canada, which is in sole possession of the information, has not explained how the amount of those fees was determined. Since Canada has raised fees as a defence to Brazil's claim that IQ guarantees confer benefits, it is Canada's burden to provide this information.

With regard to fees for loan guarantees, another arguable defence, under an *a contrario* interpretation of Item (j) of Annex I to the SCM Agreement, would be that fees sufficient to cover the long-term operating costs and losses of the guarantee programme are sufficient to exclude such a measure from the prohibitions of Article 3. It would be up to the party invoking any protection afforded by Item (j), however, to establish its eligibility for any such protection. Canada has not even attempted to do this.

Moreover, there is no Item (j) equivalent for equity guarantees. Brazil has also presented unrebutted evidence that the market does not offer these guarantees. Exhibit Bra-50 includes letters from leading financial institutions stating that equity guarantees are not offered on the market. Thus, with regard to equity guarantees, Brazil has established that Canada is offering something that the market does not provide, apparently at any price. This, in Brazil's view, is quintessentially a benefit. Even assuming for the sake of argument that the market might provide equity guarantees at some price, it would be up to Canada to show (1) that the price it charges is equal to or more than the market price and (2) that the market price is that of a guarantor whose credit rating is equal to or better than that of Canada or Québec, as the case may be.

With respect to [], please see Brazil's comment on Question 48, above, as well as paragraphs 143-146 of Brazil's Second Written Submission.

ANNEX A-12

ORAL STATEMENT OF BRAZIL AT THE SECOND MEETING OF THE PANEL

(31 July 2001)

Mr. Chairman, Members of the Panel, Members of the delegation of Canada,

1. In its submissions thus far in these proceedings, Brazil has presented evidence that subsidies provided by Canada through the Canada Account and the Corporate Account of the Export Development Corporation, and subsidies provided by Canada through the Province of Québec, are prohibited by Article 3 of the Subsidies Agreement.

2. The public record, however, contains only fragments of the relevant information, and during the several years in which the dispute between Brazil and Canada has taken place, Canada has steadfastly refused to provide relevant information. Indeed most of the information Brazil was able to obtain came from third country sources where customers of Bombardier, the Canadian aircraft manufacturer, were required to disclose aspects of their finances to public investors. Very little came from Canada itself.

3. Thanks to the efforts of this Panel in taking its responsibilities under Article 13 of the DSU seriously, however, that situation has changed. You have asked the questions that needed to be asked, and Canada finally has come forth with information that should have been either notified to the Subsidies Committee long ago or provided to Brazil in consultations, consistent with the Appellate Body's requirement that Members be "fully forthcoming" at all stages of WTO dispute settlement proceedings.[1]

4. The bulk of that information was provided by Canada in its response to Questions from the Panel filed on Thursday, 26 July. In the two business days afforded to review that information, our team has been working ceaselessly in an effort to analyze it in the context of the issues presented in this dispute. There is much information, some of which, as I shall point out, raises even more questions.

5. Responding to this information, which we are seeing for the first time, will take some time, but we think it is important that we be as complete as possible. So I apologize in advance for the length of this statement.

6. This statement is organized in the following manner. In rebuttal to arguments made by Canada, I will show why EDC's Canada Account and Corporate Account confer a benefit, why the guarantees provided by IQ confer a benefit, why the guarantees provided by EDC and IQ are prohibited subsidies, and why IQ is contingent on export. I then will discuss specific transactions supported by the challenged Canadian programmes, beginning with the Air Wisconsin transaction.

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[1] India – Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R (Adopted 16 January 1998), para. 94.

7. Before I proceed, however, Mr. Chairman, I would like to make a preliminary point. In footnote 1 of its Second Submission, Canada asks Brazil to clarify whether by referring to "EDC," Brazil intends to refer to anything other than EDC's Corporate Account. Brazil is not aware that EDC has any operations other than Canada Account and Corporate Account, both of which are the subject of Brazil's claims. Canada's First Written Submission, at paragraph 20, describes EDC in these terms. If any other operations exist, however, Brazil, and, I am sure, the Panel, would be very interested to learn of them.

I. EDC Confers a Benefit

8. Canada has not contested that support *via* either the EDC Corporate or Canada Accounts is a financial contribution that is contingent on export. Canada has argued, however, that EDC Corporate and Canada Account support does not confer a benefit.

9. In response to Question 44 from the Panel, Canada argues that Bombardier's inability to make equally attractive financing available to its customer in the absence of EDC support is irrelevant. According to Canada, it is the purchaser of Bombardier aircraft, not Bombardier itself, that requires financing. In Canada's view, the financial contribution is made to the purchaser, so, therefore, the sole issue is whether the purchaser – the recipient of the financing – received a benefit.

10. Canada's argument is flawed. Nothing in the text of Article 1.1(b) of the Agreement suggests that there must be only one recipient of the benefit. That article does not read: "a benefit is thereby conferred *on the recipient of the financial contribution*." It states simply, "a benefit is thereby conferred," meaning, conferred on anyone.

11. EDC's financial contribution allows Bombardier to offer its customers a product on terms more favorable than the terms it could afford to offer without EDC's support. A benefit is conferred on Bombardier because, as a result of the financial contribution made through EDC, the necessity for Bombardier to lower its price in order to win customers is eliminated or reduced. The Panel in *Brazil – Aircraft* recognized that a financial contribution provided to a purchaser or a lender in support of an export credit transaction also benefits the producer. That Panel said:

> 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. … [These] payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market … [T]his will … 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.[2]

12. Canada's claim that EDC's Corporate Account operates "on commercial principles" has no bearing on this conclusion. In spelling out an alleged market benchmark in paragraph 67 of its First Written Submission, Canada focuses unduly on its claim that Bombardier customers do not receive "benefits" from EDC Corporate Account support. In so doing, it ignores a key beneficiary of the transactions – Bombardier itself, which uses EDC because it cannot find equally favourable financing elsewhere.

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[2] *Brazil – Export Financing Programme for Aircraft – Second Recourse to Article 21.5 of the DSU*, WT/DS46/RW/2 (26 July 2001) (Not yet adopted), para. 5.28 (note 42) (emphasis in the original).

II. The Guarantees Provided by IQ Confer a Benefit

A. The guarantee fees charged by IQ are not "at market"

13. As with EDC, Canada claims that IQ charges "market" fees for its guarantees. Canada argues, in its answer to Question 47 from the Panel, that the guarantee fees charged by IQ are at the market rate because "the effective risk exposure of IQ," which "is key to the determination of what constitutes an appropriate fee," "is greatly diminished" as a result of [ ].[3]

14. There are a number of points to be made with respect to that argument. **First**, []. By providing guarantees to the borrower, IQ facilitates more favourable financing terms because of Québec's superior credit rating, thus conferring a benefit. This is what "sweetens" the deal for the purchaser of Bombardier aircraft, and therefore, for Bombardier itself. That IQ might be provided [] is irrelevant to the question of "benefit."

15. The Air Wisconsin transaction provides a perfect illustration of Brazil's point. By Canada's own admission, the [] "is not part of the offer to Air Wisconsin" because the []."[4] When the purchaser goes to a lender or looks for equity investors with an IQ guarantee, the lender or the investors see only the full [] per cent IQ guarantee backed by the credit rating of the Government of Québec. The [] might mitigate IQ's exposure, but does not reduce the benefit to purchasers and Bombardier.

16. **Second**, contrary to Canada's assertions, it appears that the []. As Brazil has explained in paragraph 144 of its Second Written Submission, the [] appear to be issued by Canadair Québec Capital ("CQC"), a company capitalized in equal parts by Bombardier and a company wholly-owned by IQ. Thus, the [] to the IQ guarantee is made by an entity that receives part of its funding from IQ itself. In paragraph 3 of its response to Question 48 from the Panel, Canada refers to Decree 879-97 of 1997 in support of the proposition that []. However, the provision referred to by Canada relates to the capitalization of CQC. Further, a subsequent decree, Decree 1187-98 of 1998, makes it clear that the [] must be provided not by [] but by CQC, a company created specifically for that purpose.[5] []

17. In this regard, Brazil would also like to point out the significance of Bombardier's involvement in the guarantees provided by IQ. The activities of IQ and Bombardier are intertwined to a very significant extent. Together, they formed CQC for the purpose of providing [] against IQ's guarantees to Bombardier and otherwise facilitating Bombardier's activities. Bombardier, as a [], obviously has an important role in determining the terms and conditions for the provision of the [] and, therefore, has an influence on the terms and conditions of the provision by IQ of the guarantees themselves. In fact, through CQC, IQ and Bombardier are business partners for the purpose of supporting and facilitating the export of regional aircraft.

18. I would like to point out, in addition, that at paragraph 117 of Canada's Second Written Submission of 4 December 1998 in *Canada - Aircraft*, Canada stated that *none* of the guarantees or financing activities under the "export development" eligibility criterion of SDI (which became IQ in 1998) was related to the civil aircraft sector.[6] In this case, however, Canada has been compelled to provide documentation demonstrating not only that IQ has, in fact, been used to assist the Canadian regional aircraft industry, but that assisting the Canadian regional aircraft industry is one of the major functions of IQ and that IQ works very closely with Bombardier to that effect – and apparently was doing so prior to December 1998.

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[3] Canadian 26 July response to Question 47 from the Panel, para. 2.
[4] Canadian 26 July response to Question 48 from the Panel, para. 3.
[5] Decree 1187-98, pg. 1, para. (a) (Exhibit Cda-35).
[6] *See* Statement of Brazil for the First Meeting of the Panel, para. 72 and Exhibit Bra-52.

19. **Third**, Canada argues, in paragraphs 3 and 4 of its response to Question 47 from the Panel, that "[] per cent of the aircraft being financed are financed without IQ equity guarantees," which "demonstrates that most of the time, Bombardier's customers are, at best, indifferent to IQ equity guarantees." The conclusion drawn by Canada is that "the fees charged by IQ in return for the guarantees are market rate."

20. Canada's logic is flawed. The fact that [] per cent of the aircraft being financed are financed without IQ equity guarantees is irrelevant. What matters is the terms of IQ equity guarantees in the cases where they are provided, whatever the percentage of those cases is. Brazil has shown that IQ confers a benefit whenever it provides a guarantee. Moreover, as Canada has explained in its response to Question 39 from the Panel, IQ has used virtually all of the funds available in its budget for support of the Canadian regional aircraft industry. Presumably, if IQ had a larger budget for that purpose, more funds would have been used to provide equity guarantees. In fact, in December 2000, the IQ fund for regional aircraft support was replenished to support the Air Wisconsin transaction.[7]

21. **Fourth**, Canada states that "IQ provides financing services in competition with other financial institutions interested in participating in the aircraft financing market."[8] However, Canada fails to specify what the financing services are and who the other competing financial institutions might be. Canada further asserts that the administrative fee charged by IQ "is routinely charged by any commercial financial institution."[9] This is a hollow assertion. We know of no commercial financial institutions that provide equity guarantees, and have submitted unrebutted evidence in Brazilian Exhibit 50 that equity guarantees are not available in the market. In order to refute Brazil's argument that IQ's equity guarantees confer a benefit, Canada must show that other financial institutions provide equity guarantees in the field of aircraft financing and charge fees equivalent to the fees charged by IQ. Canada has not done so. It has merely pointed out that suppliers of aircraft engines sometimes contribute to equity guarantees for aircraft that use their engines. But this is a guarantee furnished by a participant in the sale. It is not a guarantee that is available from a financial institution in the market.

22. Moreover, the most recent Québec decree, which was issued in 2000 to replenish the IQ guarantee fund for the Air Wisconsin transaction, eliminates the requirement that fees even be charged.[10] Nevertheless, Canada still argues that in fact fees are charged. It relies on paragraph B of the IQ criteria set out in Canadian Exhibit 51, which requires that "IQ will not make support available for transactions if the remuneration it is to receive is less than that offered in the market."[11] A closer look at paragraph B, however, demonstrates otherwise. According to paragraph B, if the "competitive nature" of the transactions requires that IQ receive less than it would in the market, it will do so. Given Canada's propensity, in the Air Wisconsin transaction, and now the recently-announced Northwest deal, to justify Canadian subsidies based on competition from Embraer, this clause in paragraph B takes on great significance.

23. The standard provided in paragraph B once again begs the question of what Canada considers the "market" to be when it comes to guarantees. As we will show below in our discussion of specific transactions, IQ has provided guarantees with no fees charged, and, when it has charged fees, it uniformly charges [] per cent regardless of the credit ratings of the airlines involved. It is hard to trace in this pattern any effort to follow a market. No market guarantor would charge the same fee to recipients with wildly varying credit ratings.

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[7] "Ottawa backs Bombardier: Loan to US firm to buy jets slaps Brazil's aerospace subsidies," *The Montreal Gazette*, 11 January 2001 (Exhibit Bra-9).

[8] Canadian response to Question 47 from the Panel, para. 4.

[9] Canadian 26 July response to Question 48 from the Panel, para. 2.

[10] Decree 1488-2000 (Exhibit Cda-36).

[11] Canadian Second Written Submission, para. 32.

24. As I have already noted, IQ guarantees will automatically confer a benefit by providing a purchaser with the Government of Québec's superior credit rating, permitting it to obtain better financing than it could obtain on its own. To demonstrate that there is no benefit, Canada would have to prove that IQ's fees are equal to those charged regional aircraft purchasers by commercial guarantors with A+ credit ratings. Under Article 14(c) of the Subsidies Agreement, there would still be a benefit as long as there is a difference between the amount the purchaser pays on a loan guaranteed by IQ, and the amount it would pay on a loan not guaranteed by IQ.

B. IQ is not a discretionary measure

25. In paragraphs 25 and 28 of its Second Written Submission, Canada argues that even if IQ were required to confer a benefit with its guarantees, it is not "mandated" to provide those guarantees. According to Canada, IQ merely enjoys the discretion to provide guarantees. Brazil has demonstrated that this is not true. Article 28 of the *IQ Act*, which serves as the legal basis for the Québec decrees under which IQ guarantees are issued, "mandates" IQ to provide assistance.[12] I note, Mr. Chairman, that Canada has not made this argument with respect to EDC Corporate or Canada Account guarantees.

26. In any event, the type of "discretion" discussed by Canada is not relevant under the traditional mandatory-discretionary distinction. This "discretion" does not remove IQ guarantees from the category of mandatory measures susceptible to challenge "as such." In an analogous situation, the GATT panel in *EC – Audio Cassettes* held that an antidumping measure would not be transformed into a discretionary measure merely because the administering authorities in a country had the discretion to initiate an antidumping investigation.[13] Similarly, any option IQ has to issue or not issue guarantees does not make the measure discretionary.

27. I also refer the Panel to the recent decision in *US – Exports Restraints*. The Panel in that case noted that "a measure is inconsistent with WTO rules if that measure mandates action inconsistent with WTO rules in particular circumstances, even if in other circumstances the action might not be inconsistent with WTO rules."[14] Analogously, in the "particular circumstances" where IQ issues guarantees, Brazil argues that those guarantees will always be inconsistent with WTO rules, even if in the "other circumstances" when IQ does not issue guarantees, it would not be acting inconsistent with WTO rules.

III. While Not Every Financial Contribution by a Government Agency Is a Prohibited Subsidy, Guarantees Provided by EDC and IQ *Are* Prohibited Subsidies

28. Brazil has shown that EDC and IQ function as ECAs and provide subsidies "as such." Canada argues that, by Brazil's logic, "any financing by an export credit agency would be *per se* illegal."[15] In Canada's view, Brazil's assault on guarantees would mean that a Member could never provide a financial contribution in the form of a guarantee without also at the same time conferring a benefit, and thus granting a subsidy.

29. But this is not the case, and Brazil has not argued that it is. For example, even if the guarantee constituted a subsidy, it would not be prohibited if it was not contingent on export (or

[12] Brazilian Second Written Submission, paras. 120-121.

[13] EC – Anti-Dumping Duties on Audio Tapes in Cassettes Originating in Japan, ADP 136, 28 April 1995, para. 362.

[14] United States – Measures Treating Exports Restraints as Subsidies, WT/DS194/R (29 June 2001) (Not yet adopted), para. 8.78.

[15] Canadian 26 July response to Question 44 from the Panel, para. 6.

domestic content). Further, export credits that conform to the interest rates provisions of item (k) are not prohibited. Moreover, an export loan guarantee at premium rates adequate to cover the long-term operating costs and losses of the programme would arguably be permitted under an *a contrario* interpretation of item (j). We understand, of course, from the position Canada took in *Brazil – Aircraft*, that it does not believe that such *a contrario* interpretations attach. This, however, is an issue the Panel need not reach, since Canada has not raised an item (j) defence.

IV. IQ Support Is Contingent on Export

30. Canada argues that IQ support is not contingent in law or in fact on export. Brazil has demonstrated otherwise. Article 25 of the IQ Act provides that IQ "s*hall* participate in the growth of enterprises, in particular by facilitating research and development and *export activities*." Thus, IQ is required to participate in export activities. It has fulfilled that requirement by granting support under Québec decrees that establish a fund *available solely for transactions involving Bombardier aircraft*.[16] And as Canada itself noted in its response to Question 19, every single regional aircraft transaction receiving IQ support under these decrees has been an export sale outside of Canada. Regional aircraft transactions are a perfect illustration, therefore, of the requirement in Article 25 that IQ support export activities, and the decrees included in Canadian Exhibits 33-36 are measures that represent IQ's fulfilment of that requirement.

31. Adding to IQ's *de jure* export contingency, I refer to other Québec decrees discussed in paragraphs 98-99 of Brazil's First Written Submission. In paragraph 35 of its Second Written Submission, Canada overlooks the second decree cited by Brazil – number 841-2000, regarding the Program for Financing Enterprises. That decree concerns IQ support for market development projects, including the sale of goods. It states that IQ support for transactions involving the sale of goods may only be extended if the goods are sold for export. Canada claims that this decree is not applicable to regional aircraft transactions. But regional aircraft are goods, Mr. Chairman, and thus the decree applies on its face.

32. I note that Article 25 of the IQ Act requires "export," period. It does not state that IQ support is conditioned on export outside of Québec. It requires "export." Québec decree 841-2000, however, does require export only "outside of Québec." Yet, in its Oral Statement for the first meeting of the Panel, and again in its Second Written Submission, Brazil has demonstrated that a requirement for recipients of IQ support to export out of Québec is a requirement that they export out of Canada.[17]

33. Even if Québec decree 841-2000 does not apply to regional aircraft transactions, however, the four Québec decrees included as Canadian Exhibits 33-36 do apply. While the decrees do not include an express export requirement, the Appellate Body in *Canada – Autos* recognized that it will be the rare case in which export contingency "is set out expressly, in so many words, on the face of the law, regulation or other legal instrument."[18] Therefore, the Appellate Body held that the legal instrument "does not always have to provide *expressis verbis* that the subsidy is available only upon fulfilment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure."[19]

34. I note, Mr. Chairman, that the "words actually used" in the decrees in Canadian Exhibits 33-36 specify that the IQ guarantees can only be granted to support transactions involving Bombardier

[16] Exhibits Cda-33 through Cda-36.

[17] Brazilian Oral Statement for first meeting of Panel, paras. 56-62; Brazilian Second Written Submission, para. 129.

[18] *Canada – Certain Measures Affecting the Automotive Industry*, WT/DS139/AB/R, WT/DS142/AB/R (Adopted 19 June 2000), para. 100.

[19] *Id*.

aircraft. The "necessary implication" of these words is that the guarantees are to support exports. Canada itself admits that a full 100 per cent of the aircraft receiving these guarantees have been exported.[20] Both the officials who grant the guarantees and the recipients themselves understand the "necessary implication" of the "the words actually used in the measure."

35. These same factors mean that IQ guarantees are also contingent in fact on export, or "tied to actual . . . exportation." Regarding *de facto* export contingency, I refer the Panel to the decision in *Australia – Leather*. That Panel stated that a Member's awareness that its domestic market is too small to absorb domestic production of a subsidized product indicates that the subsidy is granted on the condition that it be exported.[21] Canada is of course aware that 100 per cent of the regional aircraft transactions receiving IQ support have been for export outside of Canada. IQ guarantees are "tied to actual . . . exportation" because IQ will not grant them unless an actual export sale of a regional aircraft occurs. IQ guarantees are, therefore, also *de facto* contingent on export.

V. The Air Wisconsin Transaction

36. Much has been said about the Air Wisconsin transaction, which involved both Canada Account and IQ support. Canada has acknowledged that its support for the Air Wisconsin deal constitutes a subsidy. Industry Minister Tobin stated it very clearly: "What we're doing is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[22] He could hardly have paraphrased the Appellate Body's definition of the term "benefit" better.

37. As I already noted, there was both Canada Account and IQ support for the Air Wisconsin deal. I will begin by addressing the three things Canada must establish to justify Canada Account support for the Air Wisconsin deal under item (k), given Tobin's acknowledgement.

38. **First**, Canada must show that it followed the requirements included in the matching provisions of the *OECD Arrangement*. Canada did not do so. It did not, for example, "make every effort to verify" that Brazilian official support was involved in Embraer's offer to Air Wisconsin. The fact of the matter is that Brazil was not involved in Embraer's offer to Air Wisconsin, and a simple question to Brazil at some time during the many months while the deal was pending would have resolved the matter. Since Brazil was not involved in Embraer's offer to Air Wisconsin, the column marked "Brazil" in the Annex to Canada's 26 July responses to the Panel's questions should be blank.

39. **Second**, Canada must demonstrate that its "non-identical" offer matched Embraer's offer. Again, it has not done so. To "match" means to offer financial terms that are the same, or at least equivalent. The statement by an Air Wisconsin official, cited by Canada from its Exhibit 2, that Canada's offer was no more favorable than Embraer's offer "in its entirety" does not prove equivalence. Equivalence of the "entirety" of the two offers is irrelevant. All that matters is equivalence of the financing terms. The chart included as Annex A to Canada's 26 July responses in fact demonstrates that the Canadian and Embraer offers were not, at a minimum, equivalent. For example, Canada's chart does not even mention the [] contained in Embraer's offer.[23]

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[20] Canadian 6 July response to Questions 19 and 20 from the Panel.

[21] Australia – Subsidies Provided to Producers and Exporters of Automotive Leather, WT/DS126/R (Adopted 16 June 1999), para. 9.67.

[22] Tobin Press Conference, para. 20 (Exhibit Bra-21).

[23] Exhibit Bra-56 (second to last page). Pursuant to Article 16 of the Panel's Working Procedures, Brazil requests that the confidential, bracketed information included in the above paragraph be excluded from the version of this submission attached to the Panel Report.

40. **Third**, Canada would need to show that recourse to matching maintains "conformity with" the interest rates provisions of the *Arrangement*. As Brazil explained in its 6 July response to Question 36, however, this is not the case.

41. Canada has not satisfied these three requirements. Consequently, it argues in the alternative that Canada Account support has not conferred a benefit on Air Wisconsin. When Canada matched a private offer from Embraer, however, it conferred a massive benefit on *Bombardier*. By taking care of the financing, Canada insulated Bombardier from the need to lower its price to clinch the deal. As one example, although [] are listed in both the "Canada" and "Brazil" columns on page v of the chart included as Exhibit A to Canada's 26 July responses to questions from the Panel, Canada is well aware that the Government of Brazil does not provide these []. While Embraer had to bear the cost of this [] itself, Canada bore that cost for Bombardier.

42. I will now briefly return to the subject of IQ equity guarantees in the context of the Air Wisconsin deal. Canada's defence is that IQ charged Air Wisconsin a fee for the guarantee. This does not appear to be true. As I have already noted, the December 2000 Québec decree that facilitated the IQ guarantee for the Air Wisconsin deal removes the requirement, present in earlier decrees, that a fee be charged. []

43. Even if IQ charged a fee of [] basis points for the guarantee, Canada must do more than simply state, again in its response to Question 48, that "[s]uch a [] basis point administrative fee is routinely charged by any commercial financial institution." Canada has not provided one example of an equity guarantee provided by any commercial financial institution, at any time, in any place, for any fee, much less an example in which a [] basis point fee is charged.

44. While Canada has provided the Panel with documents regarding other IQ guarantees,[24] *it has failed to do so for the Air Wisconsin guarantee*. Documents provided by Canada about other IQ guarantees demonstrate that 60 per cent of the other regional airlines receiving those guarantees have [] credit ratings. Since Canada has not provided the relevant document with respect to the Air Wisconsin transaction, the Panel should presume that Air Wisconsin's credit rating is similarly []. Canada itself described Air Wisconsin as "a relatively low quality credit."[25] Canada has not established that a commercial financial institution with an A+ credit rating would charge [] basis points to provide a guarantee to a [] credit risk. IQ support for the Air Wisconsin transaction therefore confers a benefit, and constitutes a subsidy.

45. I have already noted that partial [] provided by CQC or [] are irrelevant, and do not dilute the value of the IQ guarantee for the recipient and Bombardier. Such a [] might mitigate IQ's exposure, but it does not reduce the benefit to the recipient or Bombardier.

VI. Other Transactions

46. I would now like to discuss the evidence before the Panel regarding particular transactions other than Air Wisconsin supported by EDC and Investissement Québec that are at issue in this dispute. Before I go through the terms of each transaction in detail, I will explain how we determined that, based on the evidence provided by Canada, the transactions at issue in this dispute were financed at below "market" rates. I would also like to make some general comments regarding the methods used by Canada to determine the market rates for each transaction.

A. Methodology

[24] Exhibits Cda-60 through Cda-64.
[25] Canadian Second Written Submission, para. 92.

1. Previous statements and benchmarks used by Canada

47. The first method we used to determine whether Canada financed at "market" rates was to compare the rates for each transaction with what Canada itself has said about the market for regional jets. A little over a year ago, as may be seen in Brazilian Exhibit 64, Canada stated that the applicable risk premia for major airlines such as Northwest and US Air are in the range of the 10-year US T-bill plus 250 basis points. Canada also stated that "British Airways, which is the best rated non-sovereign airline, obtains rates of LIBOR plus 30 to 40 bps for large aircraft deals (an additional 20-30 bps should be added for regional aircraft), even for clients with British Airways' credit rating. This translates to US T-bill plus 105 to 120 basis points (125 to 150 for regional aircraft)" when the appropriate swap spread is added.[26] I should note that the "swap spread" represents a calculation of what it would cost to convert a floating rate to a fixed rate. While swap spreads may vary over time, the current "swap spread" between LIBOR and T-bill rates is approximately the same as it was at the time of Canada's statements – approximately 75-85 basis points.

48. Based on these figures, Canada stated that "in December 1999, a representative sample of airline companies operating in the US market obtained financing at T+110 to 250 basis points"[27] and airlines like British Airways, American, Northwest and US Air "enjoy credit standings significantly better than a number of airlines in the industry. Airlines that are less credit-worthy can face spreads as high as 350 bps."[28]

49. Thus, in Canada's view, the appropriate spread for the *best-rated* airline for a regional jet transaction would be either LIBOR + 50-70 bps (floating rate) or T-bill plus 125-150 bps (fixed rate transactions). For a "*representative*" airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up to T-bill + 250 bps. Airlines that are *less credit worthy* have a credit rating "in excess of T + 350 bps."

50. In addition, credit spreads tend to be lower for North American transactions than for deals involving airlines in other markets. Transactions involving regional jets have higher spreads than transactions involving large aircraft.

51. I would also note that before the second Article 21.5 Panel in *Brazil—Aircraft*, Canada reiterated that as of 31 January 2001, no US airline whatsoever had any kind of an "A" rating.[29] There is no reason to believe that the credit ratings for all airlines have plummeted in the last two years. The ratings provided by Canada in response to this Panel's questions must be viewed in the context of these statements.

2. Canada's Credit Ratings Are Inconsistent with the Market

52. Brazil next compared the credit ratings provided by Canada to ratings that are publicly available through credit agencies such as Standard & Poor's and Moody's. We noted that in many cases, Canada's ratings are flatly inconsistent with the ratings that are available publicly. For example, Canada rated Comair at one point as [].[30] When I discuss particular transactions, I will

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[26] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (Adopted 4 August 2000), Annex 1-2, Rebuttal Submission Of Canada, 17 January 2000, para. 51, note 26.

[27] WT/DS46/RW, Annex I-5, paras. 10-11.

[28] WT/DS46/RW, Annex 1-3, Oral Statement Of Canada, 3 February 2000, chart 3 (submitted with exhibit Cdn-14) (Exhibit Bra-64).

[29] WT/DS46/RW/2, para. 5.36, n. 51

[30] WT/DS46/RW, Annex I-5, para. 10.

provide more examples of how Canada's ratings, and the spreads it associates with those ratings, are inconsistent with the market.

53. Canada also relies extensively on its LA Encore software system to establish credit ratings for airlines involved in EDC or IQ transactions. As Brazil pointed out in its reply to Panel Question 40 on 26 July, there is not much information available about how the LA Encore system actually works. We do not know precisely which data are input into the system, what weights are given to each parameter, and whether or not subjective criteria are used in evaluating the data.

54. Nevertheless, it appears clear that the LA Encore system is not reliable. Canada states that in 1996, using a pre-LA Encore methodology, it assigned Comair a rating of [].[31] Subsequently, Canada input Comair's 1996 data obtained from the FAMAS commercial financial analysis system into the LA Encore system and generated a rating of [], which is [] full notches [] the rating estimated by EDC. Similarly, in its response to Question 45, Canada explains that prior to using LA Encore, Canada rated ASA, at the time of its first letter of offer, as []. Canada goes on to say that had LA Encore been available, it would have assigned a rating of [] to ASA, which is a full [] notches [] the previous rating. These facts suggest that either EDC's own ratings or the ratings generated by the LA Encore system are consistently inaccurate. Canada does not appear to have further investigated these discrepancies or revised the LA Encore system to adjust for the difference between its output and Canada's own previous estimates. We are left, therefore, with a software program that when used by Canada, seems to overstate credit ratings by anywhere from [] to [] notches. Given that each notch may account for a difference of approximately 15 basis points in the spread offered to a company, this discrepancy could make a difference of between [] and [] basis points in an offering spread. This raises serious questions regarding the reliability of offers developed based on the LA Encore output.

3. Canada Uses Comparables That Are Not Reliable

55. The problem with Canada's use of inflated ratings is that it enables EDC to bypass the risks associated with the regional jet market and instead base its regional jet financing on a comparison with industrial papers that carry far less risk and are completely unrelated to the regional jet market. For example, in one pricing matrix in Exhibit 59, Canada has rated Comair – a company never rated by Standard & Poor's – as an [] grade, and proceeds to base Comair pricing on comparisons with companies like []. This just does not make sense.

56. In fact, we have found that in most cases these comparables are simply not reliable or useful in determining market rates for regional jet financing. But first, let me discuss the most important comparable that Canada has *not* used. Canada does not appear to have used any data regarding regional jet transactions that did *not* involve government support as benchmarks to determine market rates. Brazil notes that in its response to Panel Question 43, Canada stated that over [] per cent of Bombardier's sales did not involve any government support, even through so-called "market window" operations. These transactions should surely provide a plentiful and accurate resource for determining the appropriate market rates for Canada's officially-supported transactions. It is difficult to see how Canada could reasonably arrive at market rates for its transactions without ever referring to the vast majority of Bombardier transactions that it claims were financed without any government participation, even market window participation.

57. Brazil also notes that in its response to the Panel's Question 4(b), Canada stated that in establishing its benchmark "market" rate, Canada defines the market – and I quote – to include "banks, other commercial financial institutions, but not export credit agencies." Despite this, it appears that Canada has relied extensively on EDC's pricing for other transactions to determine "market" rates. For example, Canada's answers to Panel Questions 37 and 45 state that Canada relied

[31] Exhibit Cda-59.

on then-current EDC pricing offered to other airlines to set rates for particular transactions. Canada explains that in formulating its []. Canada then states that its [] was based on EDC's previous pricing to Comair! This is purely circular – first Canada finances Comair with reference to what it previously offered to []; then it finances [] with reference to what it just provided to Comair. This does nothing to establish whether these transactions are at actual market rates. Moreover, Canada's statement that it considers the market exclusive of export credit agency transactions is untrue. In fact, Canada is relying on a self-justifying market consisting of its own transactions – the transactions of an export credit agency.

58. Brazil also notes that in at least one instance in 1996, shown in Canadian Exhibit 59, EDC has relied on "[]" in determining the rate at which to provide financing. This is consistent with Minister Tobin's statement, almost five years later, regarding the Air Wisconsin deal, that Canada used EDC "to give a better rate of interest on a loan than could otherwise be secured by Bombardier." Obviously, the [] has nothing to do with the market rate for the deal and completely undermines Canada's arguments that EDC actually seeks to finance Bombardier transactions at market rates. It seems reasonable to assume that the "[]," and the willingness of EDC to accommodate Bombardier with below market rates were the determining factors in deciding which transactions, and at which rates, were supported by EDC between the date of the 1996 memo provided in Canadian Exhibit 59 and Minister Tobin's statement earlier this year.

59. Many of the other comparables relied on by Canada are also of little value in establishing market rates for regional jet transactions. In many cases, Canada relied on rates at which general US industrial bonds were trading to establish rates. However, Canada does not appear to have considered or adjusted for whether those general industrial bonds were representative of conditions in the airline industry, especially the regional jet industry. Given the apparent availability of over seventy per cent of Bombardier transactions as potential comparables, the reliance without further analysis on general industrials is unreasonable and would not have produced reliable market rates. Furthermore, while Canada relies in several instances on the general industrial spreads, in other instances, Canada does not even discuss these. The likely reason, as I will demonstrate shortly, is that Canada's spreads are frequently below even the general industrial spreads.

60. Canada also relied on other transactions that were not comparable in any meaningful sense to establish its market rates. For example, in its Exhibit 39, Canada based its pricing for a sale of regional jets to Kendell Airlines in part on a comparison to the terms of a sale of a single []. Thus, Canada compared a sale of up to [] regional jets with a value of approximately $[] million to a small non-US regional airline with a non-aircraft $[] million sale to a $[] billion-dollar US company. For obvious commercial and financial reasons, this is simply not a relevant comparison.

61. Finally, Brazil notes that according to the response to Question 37, Canada relied on financing offered by [], which Brazil understands to be a reference to []. Canada has not explained how [] financing data are helpful in establishing true market rates for regional jet financing.

4. Comparison with EETC Issues

62. In several instances, Canada has said that it relied on spreads for Enhanced Equipment Trust Certificates (EETCs) to determine financing rates for EDC and IQ supported transactions. EETCs are a relatively new financial instrument for debt financing in the aircraft sector, in use since the mid-1990s. EETCs have been described as a cross between a corporate bond and an asset-backed security and now account for approximately 75 per cent of all debt raised by US airlines. EETCs are typically backed by both the credit quality of the underlying issuers and specific aircraft as collateral. To date, EETCs have generally been used in the large aircraft sector and have not been used much in the regional jet sector. In addition, the issues are for the most part secured by large aircraft rather than by

regional jets. The value of the collateral enables airlines with poor credit ratings to obtain better credit ratings than they would otherwise hold.

63. EETCs have been particularly successful in the North American market because of a provision of the US bankruptcy code which permits holders of the security to obtain almost immediate possession of the aircraft used as collateral in the event of an airline defaulting and filing for bankruptcy. This explains why the EETCs have not yet become popular in European and other markets.

64. As these details suggest, there are considerable differences between an EETC issue and a straightforward bank-financed loan. These include the fact that EETCs are securitized transactions in a secondary market, that EETCs generally are secured by large rather than regional jets, that EETCs are generally not used outside the North American market, and that the credit ratings may be affected by the size and the term of the transaction. For these reasons, the credit risk or spread on a EETC issue would generally be lower than the spread that the same airline could obtain in a commercial bank-financed transaction. Canada has used the EETC spreads as a benchmark for determining market rates, both in the *Brazil – Aircraft* case, as Brazil has shown in its Exhibit 64, and in this case itself, as in Canadian Exhibit 17. Therefore, Brazil considered it appropriate also to rely on the EETC spreads as a benchmark. Accordingly, Brazil has compared the rates offered by Canada with spreads in EETC transactions, in several different ways.

65. First, Brazil compared the spreads offered by Canada with the weighted-average of the spreads at which all EETCs issued by each airline were trading at the time of the Canadian offer. These comparisons are provided as Exhibit Bra-65. When I review the details of each transaction for which data is available, I will show how the spreads offered by Canada are in every instance lower than the spreads at which EETCs are trading.

66. Second, as a cross-check, Brazil compared the spreads offered by Canada with an estimate of the likely spread for that transaction based on the average spreads for all EETCs in the year in which the transaction took place. For this comparison, Brazil took the average offering spreads from all EETCs issued in the year of each Canadian transaction as its starting point. We then added the impact of the credit rating of the company based on Canada's ratings, with which, I emphasize, we do not agree. This impact was calculated as plus or minus 15 basis points based on an analysis of all EETCs offered during the period 1996-1999, which is the period covering the Canadian transactions at issue here. As shown in Exhibit Bra-66, Brazil compared the spread offered by Canada, where known, to the constructed spread based on the EETC spreads to determine whether EDC's rate was below market.

67. Much of the available data regarding Canada's transactions were provided in its responses to the Panel's questions on 26 July. Accordingly, Brazil has not had time to do a comprehensive analysis of these transactions in the two business days since it received Canada's latest data. Nevertheless, several things are clear: first, for the reasons I have just explained, Canada's methods of setting rates for officially-supported financing are not compatible with the market; second, Canada's financing is for terms longer than permitted under the *OECD Arrangement*; and third, as I will now show, Canada's rates for particular transactions were well below any reasonable definition of the market.

B. Transactions

1. Atlantic Southeast Airlines

68. Canada offered financing to Atlantic Southeast Airlines (ASA) in several steps. Again, I will discuss these sequentially. ASA bought [] CRJ 200 aircraft, with options on an additional [], from

Bombardier in April 1997. The terms of EDC's offer are provided in Canadian Exhibit 42. EDC financed up to [] per cent of the price of these aircraft, at a rate of US 10-year T-bill plus [] basis points. The financing had a term of [] years.

69. Let us first look at the credit ratings assigned to ASA by Canada in April 1997. Canada states in response to Question 45 that at the time of the first offer, it did not have its LA Encore software available and therefore relied on a [] for ASA of [], making ASA []. By the time of the second offer, LA Encore had been developed and gave ASA a credit rating of [].

70. Quite apart from the discrepancy between EDC's own ratings and the LA Encore ratings, to which I have previously referred, ASA's ratings stand out in []. Brazilian Exhibit 67 shows the Standard & Poor's credit ratings history for most major US airlines. According to the Standard & Poor's ratings, in April 1997, [] had a rating of [], [] had a rating of [] (changing to [] in late April) and [] had a credit rating of []. Yet Canada assigned ASA, a small regional airline, a rating of []. Canada has not explained why ASA's rating should be [] than these other major airlines.

71. The pricing at T-bill plus [] points for this transaction is plainly below market. As Canada has previously stated, the best-rated airline could only hope to obtain spreads of T-bill plus 125 basis points, at a minimum. Moreover, the table provided as Exhibit 66 shows that this transaction was approximately [] basis points below the estimated market pricing.

72. On 26 August 1998, Canada offered additional financing on similar terms as the first offer, as shown in Canadian Exhibit 43. By now LA Encore had given ASA a rating of []. However, [] was rated [], [] was rated [], [] was rated [], [] was rated [], and [] was rated []. Today, the two highest rated airlines are [], which has an [] rating, and [], which has a [] rating. Again, ASA, a regional airline which is not rated by the major ratings agencies, was given a [] rating than any of these companies, and Canada does not explain why.

73. ASA's spread is also at odds with the market. Canada offered ASA financing at T-bill plus [] basis points. The most immediate measure of how this is below the market is that it is [] prevailing at this time. As the Panel is aware, the Appellate Body has stated that a rate below the CIRR is a "positive indication" that the government support provides a material advantage and is presumptively below the market.[32] Furthermore, Canada stated before the first *Brazil – Aircraft* Article 21.5 Panel that on certain occasions it has provided financing at rates below the prevailing CIRR.[33] However, Canada explained that it only did so because of the time lag required for the CIRRs, which are announced monthly, to adjust to the market. As we will see today, Canada has offered [] on at least two occasions, based on our review of the very limited number of transactions for which data are before the Panel.

74. The US dollar denominated CIRR in effect on 26 August 1998 was 6.52 per cent. The monthly average 10-year T-bill for August 1998 was [] per cent. Thus, Canada's effective rate of [] per cent plus the spread of [] basis points gives a total rate of [] per cent. This is [] basis points []. Canada bears the burden of rebutting the presumption that this rate is below the market. This Canada has failed to do. Furthermore, Canada's assertion that it [] simply because of a time lag does not withstand scrutiny. Because the CIRR is set at the 7-year Treasury plus 100 basis points, by pricing at 10-year T-bill plus []. Brazilian Exhibit 70 contains the source documentation for the applicable CIRR and T-bill rates.

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[32] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (Adopted 20 August 1999), para. 182, n.2.

[33] WT/DS46/RW, Annex I-4, question 4(a).

75. In addition, this spread is below what Canada has previously said the best-rated non-sovereign airline could expect to get in a regional jet transaction. Moreover, as the graph included in Exhibit 65 shows, it is below the weighted-average of all the EETCs trading for each of the companies participating in the EETC market in July 1998. To the extent that EETCs represent the market, EDC's financing to ASA is []. Finally, the table provided in Exhibit 66 shows that ASA's spread is [].

76. Finally, Canada has not established that there is an alternative market benchmark below the CIRR, nor has it pointed to *any* truly commercial operations comparable to these transactions.

2. Comair

77. Let me know turn to the Comair transactions. Before addressing the substantive issues in these transactions, I would like to discuss one preliminary point concerning the obligation placed upon Members by Article 3.10 of the DSU to engage in WTO dispute settlement in good faith. The extent to which this obligation is ignored, and the difficulties Members face in enforcing Canada's obligations under the Subsidies Agreement, is nowhere more evident than in the case of the Comair transaction.

78. In its First Written Submission, Brazil cited to Comair filings with the US Securities and Exchange Commission stating that EDC supported Comair purchases of Bombardier jets with guarantees. Canada denied this claim in paragraph 65 of its First Written Submission.

79. Canada denied the claim because Brazil – or rather Comair's filings with a US Government agency – misidentified the form of support involved – guarantees as opposed to loans. Brazil was not merely relying on rumour to substantiate its claim, however. It relied on official filings by Comair to an agency of the US government that, by the way, identified the correct vehicle for Canadian support – EDC. In these circumstances, for Canada to sit back and remain silent about EDC support for the transaction simply is not consistent with its obligation to participate in these proceedings in good faith.

80. And in any event, we now discover that Comair's filings with the US SEC were actually correct. In footnote 1 to its 26 July response to Question 37, Canada acknowledges that EDC did in fact provide guarantees for the Comair transaction, including in 1995, after the effective date of the Subsidies Agreement. Because these guarantees were provided by EDC's *Canada Account*, rather than its *Corporate Account*, Canada felt it was consistent with its good faith obligation to deny Brazil's claim. But Comair's US SEC filings simply refer to "EDC," without specifying Canada Account or Corporate Account. Canada's denial of Brazil's claim was therefore untruthful. Canada has not provided information about the 1995 guarantees to Comair described in footnote 1 to its response to Question 37. Under the circumstances, Brazil requests that the Panel presume that those guarantees were granted on below-market terms.

81. It appears that Brazil has fallen prey to similar Canadian tactics with respect to the 1999 Northwest transaction identified in Brazil's First Written Submission. While Canada denied IQ or SDI support for Northwest and ASA in its responses to Questions 14 and 38 from the Panel, it acknowledged EDC support for ASA. It has remained silent regarding EDC Corporate or Canada Account support to Northwest for the 1999 deal, however. Because the extent of Canada's tactics are only now coming to light, Brazil requests that the Panel ask Canada whether EDC Corporate or Canada Account support was provided for this deal.

82. Allow me to turn to the substantive issues raised by the Comair transactions. In its submission of 26 July, Canada acknowledged that it provided loans into US leveraged lease structures for [] aircraft delivered from 1996 to 2000. Canada provided an explanation of how it priced the

financing for these deliveries that raises far more questions than answers. For example, Canada states that EDC had estimated Comair's credit rating in April 1996 to be [].

83. Canada also states that, using the LA Encore software, it now estimates Comair's 1996 credit rating as []. As I have noted, this discrepancy suggests that the software is not reliable. I might also add that the LA Encore estimate of Comair's credit rating is flatly contradicted by Canada's statement in the *Brazil – Aircraft* proceedings that [].

84. Canada offered pricing in April 1996 at T-bill plus [] basis points. This is [] basis points below EDC's [] and also is [] than the spread of T-bill plus [] to [] basis points that Canada has said the best-rated non-sovereign airline, [], can obtain in the market for regional jet transactions. Once again, the pricing is below what could be obtained in the market, as shown in Exhibit 66.

85. Canada further explains that EDC lowered its pricing in December 1996 and March 1997 to T-bill plus [], in part due to "Comair's strong financial performance." At this point, Canada's offer was [] basis points below EDC's []. Canada apparently treated Comair as a [] rated credit, which would make it one of the highest rated airlines in history.

86. In August 1997, using the LA Encore software, Canada assigned Comair an [] rating. Canada's spread for this transaction was T-bill plus [], according to the memorandum provided in Canadian Exhibit 59. Canada fails to explain why, if Comair had such "strong performance," its LA Encore rating dropped [] notches ([]) in just a year.

87. Canada also fails to explain why, given this drop in Comair's rating, EDC was willing to reduce its pricing. Canadian Exhibit 59 shows that on 12 August 1997, EDC now offered a rate of T-bill plus [] basis points, which was [] basis points below its []. This represents the second occasion on which the data before the Panel shows that EDC offered [].

88. The US dollar denominated CIRR in effect on 12 August 1997 was 7.46 per cent. The monthly average 10-year T-bill for August 1997 was [] per cent. Thus, Canada's effective rate of [] per cent plus the spread of [] basis points gives a total rate of [] per cent. This is [] basis points []. Canada bears the burden of rebutting the presumption that this rate is below the market. Again, Canada has failed to do so.

89. Canada further claims that sometime between December 1996 and March 1997, Comair received bids to do an EETC issue. Brazil understands that it is not possible to do an EETC issue without a credit rating from one of the major ratings services, such as Standard & Poor's or Moody's. If Comair had received bids to do an EETC, it would likely have applied for a rating. Canada does not provide details regarding any such application. Moreover, given the advantages of EETC financing that I have described, Canada does not explain why Comair did not avail itself of this offer to issue EETCs.

90. On 10 March 1998, EDC made a new offer to Comair of T-bill plus [] basis points, as may be seen in Exhibit 59. This was considered as [] basis points below EDC's []. EDC still rated Comair as a [] risk at this time. As may be seen in the Standard & Poor's ratings history provided as Brazil's Exhibit 67, [].

91. EDC's March 1998 pricing is also [] the weighted average spread of all transactions for each airline participating in the EETC market in that month, as may be seen in Brazilian Exhibit 65. This pricing is also below Brazil's estimated market price by [] basis points, as shown in Brazilian Exhibit 66.

92. Canada states in its responses that as of its February 1999 offer, Comair's rating had [] another [] notches to [], even though Comair was considered "first among its peers in the industry." Again, Canada does not explain the inconsistency. Canada now offered a fixed rate of T-bill plus [] points, based on increase in EDC's cost of funds, according to Exhibit 59. I would note that Canada's response to Question 37 states that the offer was at T-bill plus [] basis points, but the 11 January memorandum provided in Canadian Exhibit 59, which was not discussed in Canada's written answers, approves the transaction at T-bill plus [] basis points. This memorandum further notes that EDC's cost of funds was T-bill plus [] basis points – only [] basis points [] than the approved offer – and [] basis points below EDC's [].

93. It seems impossible that Canada could consider an offer of [] basis points [] its cost of funds to be at market for a fixed rate loan with a term of [] years. It also seems impossible that Canada would consider a return of [] basis points [ ] its cost of funds, and [] points [] its [], to be a "market" level risk for a fixed rate loan to a company with a rating that has been [] steadily according to its own LA Encore software. I note that before the first Article 21.5 Panel in *Brazil – Aircraft*, Canada told the Panel that while spreads of less than 10 basis points are common in the large aircraft sector, spreads of less than 20-30 basis points, net of risk premia and transaction costs, would be "unlikely" in the regional jet sector.[34]

94. Moreover, even assuming the February 1999 offer was at T-bill plus [] basis points, this was still well [] the EETC market. As the chart provided as Exhibit 65 shows, EDC's offer to Comair at that rate was [] than the rates at which all EETCs issued by other airlines were trading in that month. Furthermore, this pricing was also [] the estimated market spread for this transaction, shown in Exhibit 66.

3. Atlantic Coast Airlines

95. Canada offered financing to Atlantic Coast Airlines (ACA) in several steps. While it is not entirely clear from the materials provided by Canada which terms applied to which aircraft, Brazil has identified several different deals that appear to have been financed by Canada. I will discuss these in chronological order.

96. In its Exhibit 59, regarding Comair's pricing, Canada refers to February 1996 pricing to ACA in which EDC offered pricing of T-bill plus [] basis points to ACA. Canada states that it rated ACA as [] at that time. Canada's pricing is [] basis points [] the spread of T-bill plus [] points that Canada has said we may expect for representative airlines, and certainly below what we might expect for a small regional airline with [].

97. I would also point out that the pricing offered to ACA is well [] the spreads at which the [], on which Canada itself relies, were trading in February 1996. I refer you to Brazil's Exhibit 68, which shows the [] over the period 1996-2001 for various credit ratings for industrial spreads. As you will see, [] rated companies were above [] basis points in February 1996. I would also refer you to the table provided in Brazilian Exhibit 66, which estimates that EDC's financing for this transaction was approximately [] basis points below the estimated market spread.

98. In its answer to Question 14, Canada states that it provided IQ equity guarantees for a sale of [] aircraft, out of [] ordered, to ACA in May 1997. In its response to Question 40, Canada states that the credit rating for ACA at the time of that transaction was []. Thus, ACA's credit rating had apparently [] over the course of a year.

[34] WT/DS46/RW, Annex I-2, para. 40.

99. Canada provides documentation regarding an ACA transaction in Canadian Exhibit 63. This consists of a recommendation dated June 1998 by CQC for a guarantee for a sale of [] Bombardier aircraft for deliveries beginning in February 1999. Canadian Exhibit 63 states that ACA had a credit rating of [] as of 1998. Grade [] is, of course, like grade [], considered to be [].

100. Canadian Exhibit 39 refers to another officially supported transaction with ACA. In analyzing its pricing strategy for Kendell Airlines, Canada refers to an April 1999 transaction involving EDC financing of an unspecified number of aircraft for a term of [] at a rate of T-bill plus [] basis points, which Canada refers to as a swap from LIBOR plus [] basis points. Canada states that ACA's credit rating at the time of this transaction was [], which Brazil understands to be the equivalent of approximately [] under Standard & Poor's ratings. Thus, ACA's credit rating apparently [] from 1996 to 1997, and then [ ] between 1998 and 1999. It appears that ACA's credit rating improves every time EDC decides to provide it with direct financing. Brazil notes that Canada has made no effort to show how ACA's rating is based on credit ratings of other regional airlines in the market.

101. In any event, the offering spread of T-bill plus [] basis points for the transaction described in Canadian Exhibit 39 appears to be well below market. First, Canada has previously stated that the spread for airlines such as [] would be in the region of T-bill plus [] basis points. Canada's rate is approximately [] basis points below this measure.

102. Also, the pricing offered to ACA in April 1999 is again well below the spreads at which the general industrial indices were trading in that month. Looking again at Exhibit 68, you will see that [] rated companies were at a spread of over [] basis points above the 10 year T-bill in April 1999. I would also refer you to the table provided in Brazil's exhibit 66, which estimates that EDC's financing for this transaction was approximately [] basis points below the estimated market spread.

103. Moreover, as the graph provided as Exhibit 65 shows, T-bill plus [] basis points is below the weighted-average of all the EETCs trading for each of the companies participating in the EETC market in April 1999, except for []. It is very interesting to note that EDC's financing of ACA, at T-bill plus [] the spread at which *ACA's own EETCs* were trading at in the market during April 1999 – a spread of approximately [] basis points. Given what I explained regarding the differences between EETCs and bank transactions, it is clear that EDC's financing of ACA is even further below what ACA could have hoped to obtain in the market for this transaction.

104. Regarding the description of this transaction in Exhibit 39, I would note that Canada compares this transaction to a sale of []. I have previously explained that this comparison is simply inappropriate. In addition, while Canada may consider the comparison between ACA and [] to be relevant, the market plainly does not. I refer you to Brazil's Exhibit 69, which shows a comparison between the spreads at which EETCs issued by various airlines traded over the period May 1998-May 2001. As you will see, ACA trades at spreads significantly [] than [] spreads. This graph also shows that EDC's pricing is consistently [] the spreads at which EETCs are traded.

4. Air Nostrum

105. Canada states in response to Question 14 that it provided financing for the sale of Bombardier jets to Air Nostrum, a regional airline in Spain, in January 1999. It appears that Canada financed [] aircraft, plus [] options, out of a total of [] ordered. Canada has not provided information as to how the remaining aircraft were financed. Brazil notes an apparent discrepancy in the dates provided by Canada for this transaction, in that Canada gave January 1999 as the date in its answer to Question 14, but the material provided in Canadian Exhibit 64 suggests the deal was approved in December 1997, with deliveries to begin in May 1998.

106. The other details of this transaction are not entirely clear. While Canada stated in its response to Question 14 that IQ only provided an equity guarantee, from the chart titled "Détails du Financement" in Canadian Exhibit 64, it appears that Air Nostrum made a [] downpayment, with the remainder of the transaction financed as debt by []. To the extent that Canada financed [] per cent of the transaction, this is clearly inconsistent with the terms of the *OECD Arrangement* limiting the amount that may be financed to 85 per cent of the transaction.

107. At this point I would note that the involvement of Canada Account, and the apparent approval of the transaction in December 1997, suggest that Canada may not have been entirely accurate when it told the previous *Canada – Aircraft* Panel that Canada Account was only involved in two export transactions in the civil aircraft sector during the period January 1995 through June 1998, involving Dash turboprops sold to [] and [].[35]

108. Québec also provided a guarantee of [] per cent of the amount financed. The summary of the transaction provided by Canada in Canadian Exhibit 64 describes this guarantee by CQC as a "garantie du gouvernement." The summary further states that the portion guaranteed by Québec would be subordinate to the portion financed by EDC ("SEE" in the French acronym).

109. The Canada Account portion of the financing appears to have been at a [] per cent interest rate – []. The CQC and EDC portions of the financing were at [] per cent. A simple weight-averaging of these three portions according to the percentages of the deal financed by each agency results in a weighted average rate for the deal of [] per cent.

110. I would further note that according to the summary of the transaction in Canadian Exhibit 64, the fee for the guarantee provided by CQC – [] per cent – appears to have been included in the financing rate for the transaction. Depending on how you look at it, therefore, either the guarantee was provided [] or the effective interest rate was [] basis points [] than I just described. If the amount of the guarantee fee is subtracted from the interest rate charged by CQC, the resulting interest rate is [] per cent, which reduces the weighted-average rate for the deal to [] per cent.

111. Brazil notes that the financing appears to have been denominated in Deutschmarks. In December 1997, the CIRR for Deutschmark-denominated transactions was 5.87 per cent. Thus, the Air Nostrum deal was financed at an overall rate that was almost [] basis points []. Moreover, since Air Nostrum's credit rating was [ ], which is [ ], this interest rate was well below market by any definition.

112. For example, at the time of this financing, the US 10-year Treasury bill was trading at a rate of [] per cent. Thus, Canada provided financing at a rate that was, in absolute terms, [] basis points above the T-bill. By Canada's own standards, which I outlined previously, one would expect the spread for a transaction involving a high risk buyer such as Air Nostrum to be upwards of T-bill plus [] basis points. Even allowing for a reasonable conversion of Deutschmark borrowing rates to the dollar, Canada provided financing at rates that were significantly below market.

113. I note that a comparison to the [] spreads provided in Exhibit 68 shows that the rate at which Air Nostrum, a [] rated company, was financed well below the spreads for similarly low-rated industrials for whichever date the transaction occurred, December 1997 or January 1999.

5. Kendell Airlines

[35] Canada – Measures Affecting the Export of Civilian Aircraft, WT/DS70/R (Adopted 20 August 1999), para. 9.217.

114. Brazil explained in its answer to Panel Question 51 that it considers the terms of the Kendell transaction to be below market. I will not repeat those details, except to point out that we do not know the interest rates at which the other banks participated in the transaction. Usually, when an export credit agency is involved in a transaction, it is the price maker, not the price taker. I would also refer the Panel to Exhibit 65, which shows that in June 1999 – the month in which EDC approved the financing – Kendell's spread, at [] basis points, was [] than every airline except [] and []. Moreover, I would note that EDC based its financing in part on a comparison between Kendell and ACA. However, as Brazilian Exhibit 65 shows, EDC's financing for Kendell was at a [] spread than [] were trading in that month. Kendell's financing was also at a [] rate than the spread estimated in Exhibit 66.

115. Finally, I would note that EDC's spread for Kendell is [] than the spreads at which similarly-rated [] were trading in June 1999. As the graph in Exhibit 68 shows, those [] were trading at over [] basis points above the US T-bill in that month.

6. Air Littoral

116. Canada has stated that it financed the sale of [] aircraft, out of a total of [] ordered, to Air Littoral, a French regional airline, in 1997. Canada states in its response to the Panel's Question 14 that IQ actually provided an *equity* guarantee for this transaction. However, the documentation provided in Canadian Exhibit 62 suggests that CQC provided a loan guarantee of [] per cent (on the "prêt senior") at a fee of [] per cent for this transaction.

117. Canadian Exhibit 62 indicates that [] per cent of the transaction was financed by unspecified banks at a rate of LIBOR [] basis points, which is very roughly equal to T-bill [] basis points. Brazil notes that according to Canada's response to Question 40, the credit rating for Air Littoral at the time of the transaction was [], which is well below investment grade. Under Canada's standard, and prevailing [], we would expect the market to finance this deal, if at all, at a rate of at least T-bill plus [] basis points. At a minimum, it is evident that Air Littoral would not have attracted equity investors absent the Canadian guarantee.

7. Mesa Air and Midway Airlines

118. Finally, I will briefly discuss two companies, Mesa and Midway, to which Canada – through either IQ or CQC – provided equity and/or loan guarantees. Canada's response to Question 14 and Canadian Exhibit 60 indicate that Mesa obtained both a loan guarantee and an equity guarantee. While the pricing for these guarantees was [] per cent, Canada has not produced any evidence to show how it determined these fees were at market rates.

119. Canada states in its response to Question 14 that it provided an equity guarantee for up to [] per cent of the Midway transaction. The documentation provided in Canadian Exhibit 61, however, suggests that CQC also provided direct financing for [] per cent of the deal, with the remaining [] per cent being raised through an EETC issue.

VII. Conclusion

120. Mr. Chairman, for the reasons stated in this and previous submissions, Brazil requests the Panel to find that support to the Canadian regional aircraft industry through Investissement Québec and EDC's Corporate and Canada Accounts constitutes prohibited export subsidies, both "as such" and "as applied."

121. In my statement today, we have included considerable argument and analysis regarding the application of these measures in particular transactions. We would have preferred to present this

argument and analysis to the Panel at an earlier phase of these proceedings. As I noted at the outset of my statement, the information provided by Canada with its 26 July responses to Panel questions is the type of information that should have been provided to Brazil in consultations. Because of Canada's failure to observe the requirement to be "fully forthcoming" in dispute settlement proceedings, we have instead had only two business days to analyze data regarding Canadian-supported transactions, and have been forced to provide that analysis to the Panel at the eleventh hour. This is not the way the drafters of the DSU, or the Appellate Body, intended dispute settlement to be conducted. We ask that you consider that fact in reviewing the evidence and argument provided by Brazil today.

122. Thank you for your attention and patience. We will do our best to answer any questions you have.

ANNEX A-13

SUBMISSION BY BRAZIL REGARDING SOURCE DATA AT THE SECOND MEETING OF THE PANEL

(2 August 2001)

SUBMISSION BY BRAZIL OF SOURCE DATA

1. In response to requests from the Chairman of the Panel and Canada, Brazil today provides the Panel and Canada with the following exhibits and data:

(a) revised copies of Exhibit Bra-65, to which Brazil has added the appropriate figures in each bar in each of the graphs contained in the exhibit.

(b) a disk containing copies of the graphs in Exhibit Bra-65 in an excel file labelled **eetc.xls**. This file also contains the data from which each graph was derived. These data consist of Morgan Stanley Dean Witter's (MSDW) periodic reports of the spreads at which all Enhanced Equipment Trust Certificates (EETCs) in the market are trading. At the first meeting of the Panel, on 26 June 2001, Canada provided the Panel with a hard copy of the current MSDW report, as Exhibit Cda-14. Brazil used essentially the same methodology as Canada used in February 2001 before the *Brazil – Aircraft* Article 21.5 Panel[1] to create the bar charts in Exhibit Bra-65. Thus, Brazil took the same MSDW data and, for each month in which Canada provided financing to the airlines listed in Exhibit Bra-65, computed the weighted average spread for each EETC traded in the market during that month.[2] The weights used to average the data were the amounts of each tranche for each company's EETC, weighted as follows:

$$\overline{S} = \frac{\sum_{i=1}^{n} A_i S_i}{\sum_{i=1}^{n} A_i}$$

where:

A_i = Amounts of the issue for each tranche (may vary from 2 to 4 tranches)
S_i = Bid Spread of Tranche I at that specific date.

A simple example of this calculation is as follows:

[1] See Exhibit Bra-64.

[2] One transaction for which Brazil made this comparison was in March 1998; however, MSDW made no data available for that month. Accordingly, Brazil based the comparison on page 2 of Exhibit Bra-65 on the closest month for which information was available (May 1998), and inflated the EDC pricing by 5 basis points.

Collateral	Class	Amt	Ratings	15/May 1998
Atlantic Coast 1997-1	A	58	A2/A–	125
6 CRJ-200Ers	B	25	Baa2/BBB	140
8 Bae J-41s	C	23	Ba2/BB-	
Issued 9/19/97	D	6	B1/BB-	
(144A–no reg rights)				

The resulting spread for this transaction would be:

$$\frac{58*125+25*140}{58+25}=130$$

(c) revised copies of the graph provided as the second page of Exhibit Bra-68 ([]), to which Brazil has added pointers marking the spreads for the transactions for which Brazil referred to this exhibit.

(d) a disk containing Exhibit Bra-68 and the source data used to generate that chart. Exhibit Bra-68 is presented in a power point file titled **bloomberg.ppt**. Both the charts presented in this exhibit and the underlying data used to create it are contained in a zip file on this disk titled **bloomberg.zip**, which contains extensive data obtained from Bloomberg's databases. These data consist of daily data for both the 10-year US Treasury Bills and the [] for each different credit rating notch. Brazil used the Bloomberg data to plot the graphs in Exhibit Bra-68 based on information in Canada's answer to question 45 and information contained in an EDC memorandum dated 18 January 1999, provided in Exhibit Cda-59, which contained information regarding Canada's [] for certain points in time. Brazil used Canada's definitions to plot the curve for all Bloomberg data for the period 1 January 1996 – 27 July 2001, as follows:

$$\text{Notch} - (\text{Spread})_t = (\text{Market Yield})_t - (\text{10-Year T-Bill})_t ,$$

Thus, for each notch (AAA, AA+, and so on), Brazil computed the spread at a given date t as the difference (in terms of basis points above the 10-year US T-bill) between the Market Yield for that specific notch and the 10-year US T-bill Yield for that particular date. In accordance with US Federal Reserve Bank practice, Brazil plotted the graph in Exhibit Bra-68 based on weekly data for each Monday, and has provided the entire dataset in the attached disk.

(e) a soft copy of Exhibit Bra-69 is contained in the file **eetc.xls**, which, as described above, also contains Exhibit Bra-65. Exhibit Bra-69 was generated using the same source data used to generate Exhibits Bra-65 and -68.

ANNEX A-14

RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(8 August 2001)

Questions to the Parties Following the Second Meeting of the Panel - 8 August 2001

Both parties

54. In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

Determining market price in situations in which there are several commercial transactions, at a range of prices, can be difficult. Fortunately, that is not the situation facing the Panel. The "market pricing" at issue here is not the *sales price* of an aircraft, but the price of the *financing terms* available from commercial sources to support sales of regional aircraft. Thus, the market benchmark against which Canada's financing must be compared is not the price for the transaction, but rather, in the words of the first *Brazil – Aircraft* Article 21.5 Panel, "the interest rates in the marketplace for regional aircraft,"[1] or, in the words of the Appellate Body, "where the net interest rate applicable to the particular transaction stands in relation to the range of commercial rates available."[2] Indeed, Canada itself has also recognised that the relevant market is that for financing terms rather than price terms, stating that "EDC offers financing at market rates by *setting the interest rate payable* to the borrower to reflect risk, in accordance with market principles."[3]

Thus, one determines the market for a given transaction by comparing the financing terms for that transaction with the financing terms that a commercial institution would provide for a similar transaction. This is the market to which Minister Tobin referred when he described Canada as providing "a better rate of interest on a loan than could otherwise be secured by Bombardier."[4] The market for financing terms should not, however, be determined by reference to other officially-supported transactions or to the *sales price* at which the aircraft are being sold.

As Brazil has explained, there are many sources of information regarding the commercial market for financing terms that can be utilised to develop an appropriate measure. In this and in the

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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), para. 6.80. Canada has also implicitly recognized that the relevant market is for financing terms rather than price terms, describing its so-called 'market window' operations as "providing financing on terms and conditions consistent with those available from commercial banks and lenders. In that sense, the borrower obtains a net interest rate *that is consistent with the market*." *Id.*, Annex 1-4, Responses by Canada to Questions from the Panel, 3 February 2000, Question 2.

[2] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB, para. 182.

[3] Oral Statement of Canada, 27 June 2001, para. 6 (emphasis added).

[4] Exhibit Bra-21, para. 20.

Brazil – Aircraft cases, Canada has utilised a number of measures of the market for financing – EETCs, Moody's and Standard & Poor's ratings, indices of general industrial bonds – but not the most relevant measure, which would be other sales of regional jets that were financed in the commercial market. Brazil has not criticised the use of these measures per se, but has noted that each of the measures has its limitations when used as a proxy for market rates for bank-financed regional jet transactions (see also the response to question 57 below) and may understate the appropriate spreads for regional aircraft. Brazil has also criticised how Canada used these indices to determine ratings and spreads for its officially supported transactions and has shown that, even using these indices, Canada's officially supported transactions were below market rates.

55. If it is commercial practice to engage in transactions at a short-term loss for long-term commercial reasons, should such transactions be treated as "market" transactions? Please explain.

Transactions in which a seller accepts short-term losses for long-term commercial reasons are not "market" transactions as that term is normally used. A seller may decide to liquidate stock at a "fire sale," for example or to penetrate a new market. Article VI of GATT 1994 and the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the "Anti-Dumping Agreement") explicitly recognise the phenomenon. Article 2.2 of the Anti-Dumping Agreement refers to sales "in the ordinary course of trade," and Article 2.2.1 provides that sales below cost may be treated as not being in the ordinary course of trade. Of course, if it is the "commercial practice" of a significant number of the sellers in a trade to sell below cost, then, arguably, the market has moved to that level. This could occur if a product faced competition from a newer product. But individual sellers can and do sell, intentionally, below market – wherever the market is – for a variety of legitimate business reasons. These could include, as noted above, the need to liquidate stock or the desire to penetrate a new market. It could also result from a desire to introduce a new product, or an existing product to a new audience. Embraer's offer to Air Wisconsin may be one such instance of an offer that is below the prevailing market.

In any event, the issue in this case is not whether Canada "engaged in transactions" at a short-term loss in the Air Wisconsin and other transactions, but whether, by financing at below what Bombardier could otherwise obtain in the market, to paraphrase Minister Tobin, Canada provided prohibited export subsidies. As explained in the response to question 56 below, by providing below-market financing in the Air Wisconsin transaction, Canada enabled Bombardier to obtain the sale *without* having to compete on price terms and risk the possibility of selling at a loss, short-term or otherwise.

56. Please analyse the significant elements of Embraer's second offer, and the Canada Account / Bombardier offer, to Air Wisconsin, and indicate how the significant elements demonstrate that such offers were, or were not, comparable.

Embraer's second offer and the Canada/Bombardier offer differed in a variety of important respects, including the following:

- Embraer's offer consisted of []; Canada/Bombardier's offer consisted of [] firm orders and no options.
- Embraer offered []; Canada/Bombardier offered 50-seat (CRJ-200) aircraft.
- Embraer's offer included []; [].
- Embraer [].

- Embraer []; []. For the same amount financed, this discrepancy will necessarily mean that the borrower under the Canadian transaction will pay significantly lower semi-annual payments than it would under the Embraer Canadian transaction.

The offers were clearly different, beginning with the number of aircraft offered. Assuming that it is theoretically possible for such different offers to be "comparable" or "equal" in an economic sense, the burden rests on Canada, the Member claiming comparability or equality to prove it. Canada has not done so. All it has offered is the contractually-mandated statement of Air Wisconsin, after the fact, that the Bombardier/EDC offer, "viewed in its entirety," was "no more favorable" than that offered by Embraer.[5] This statement does not explain how Air Wisconsin 'viewed' the two offers in "their entirety" or why the Bombardier/EDC transaction, with a different value from the Embraer offer and covering very different aircraft, was "no more favorable" than the Embraer offer.[6]

Moreover, the statement does not address the issue before this Panel – whether the *financing terms* of the two transactions were economically equivalent. It also does not address the larger question, which the Panel would face were it possible to answer the first question in the affirmative. That question is whether it is even permissible for an export credit agency to get into a bidding war, in alliance with a national manufacturer/seller, to compete with a private manufacturer/seller who is offering its own financing to support the sale of its goods. Brazil submits that such bidding wars are impermissible, and will only promote a "race to the bottom," at the expense of free and open competition. Of course, an ECA may legitimately offer support that is eligible for the safe haven of item (k) of Annex I. The support Canada offered, however, does not qualify for this safe haven since it exceeds the 10 year maximum term established by the *OECD Arrangement*.

Brazil

57. Brazil has expressed concern regarding the use of indices of general industrial bonds. In particular, Brazil has asserted that such ratings do not take account of the fact that there may be different risks involved in an airline company as opposed to an industrial company. Why would such different risks not be dealt with by the fact that companies are rated, so that if an airline company is higher risk than an industrial company, it will typically be rated lower?

Brazil believes that the utility of indices of general industrial bonds as a proxy for identifying market rates for financing of regional jet transactions is limited by several factors. First, the [] general industrial corporate bonds represent simple averages at which bonds issued by a wide variety of companies in a wide variety of industries are trading at a given point in time. While bonds issued by airlines may be included in the calculation of this average, the average itself does not reveal whether bonds issued by a particular sector should be valued above or below the average at a particular point in time.

Second, there are substantial differences in liquidity between the average industrial spreads and a bank loan financing a regional jet purchase. The industrial spreads are based on thousands of bonds being traded in huge volumes (with daily trading volume estimated at $10 billion) by traders around the world each day. A bank loan to finance a particular purchase of a regional jet, on the other hand, is an isolated transaction, much less liquid, requiring much greater and more immediate assumption of risk by a lender than the lender would experience buying and selling general industrial bonds.

[5] Exhibit Cda-2.

[6] Brazil has previously explained that the Air Wisconsin statement is of little value because Air Wisconsin was contractually required by Bombardier to make this declaration. *See* Brazil's Response to Question 34, 6 July 2001.

Third, general industrial bonds do not accurately reflect the spreads for industry sectors that may not normally be publicly rated or issue corporate bonds, such as many airlines that purchase regional jets. Moreover, the different risks between airline companies and industrial companies are not necessarily reflected in the different ratings of the companies. As noted above, the broad industrial averages are simply averages. A major airline rated A-, such as Southwest Airlines, may trade at a different spread than, for example, a major computer company with the same rating. This difference in spreads reflects differences in the market estimation of the prospects for each industry, the nature of the collateral securing each bond, competitiveness within each industry, and the manner in which the bonds are structured within each industry. These factors are reflected to some extent within the ratings, but are largely left to the discretion of the market. Put simply, spreads change a lot more frequently than do credit ratings. In the event of a change in the performance of a particular bond issuer or its industry, the market will react much more immediately than will the credit ratings agencies. The result will be a discrepancy between the spreads at which similarly rated companies in different industries may trade.

The market agrees that the general industrials curves do not reflect the peculiarities of the regional airlines industry. For example, in a report on EETCs, Salomon Smith Barney ("SSB") states that "EETCs trade at a considerable premium compared with comparably rated generic corporate bonds."[7] SSB further states that "… investors demand a spread premium for EETCs because of their close link with the highly volatile and cyclical airline industry. The overall credit profile of the airline industry is considerably lower than the average credit profiles of the market at large. … Aside from the low credit ratings of most airline EETC issuers, we believe that the market demands a credit-related premium because of the airline industry's historically high degree of trading volatility. Furthermore it doesn't help that the airline sector has been a chronic underperformer in the equity market."[8] In addition, SSB notes that "… some investors do not perceive this sector to be particularly liquid, or at least not as liquid as other corporate sectors."[9]

SSB's analysis supports Brazil's and the market's views that companies with the same credit rating will not necessarily enjoy the same spreads when issuing papers in the bonds market. Aside from the obvious fact that a loan differs radically from a corporate bond or from an asset backed security, the airline sector as a whole will normally enjoy much higher spreads than other industrial sectors. In other words, even if the general industrials curve could be used as a benchmark for the pricing of loans, a bank loan to an airline should be priced with a "considerable premium" over the curve value. EDC's pricing strategies do not give any consideration whatsoever to these particularities of the airline industry, which are even more acute for regional airlines than for the large aircraft sector.

Moreover, the similarity in ratings does not in itself mean that companies will obtain financing at the same spreads for particular transactions. Contrary to paragraph of 45 of Canada's statement, and notwithstanding its name, Southwest Airlines is a major airline with revenues of $5.6 billion in 2000 and a fleet of over 350 Boeing large jets and no regional jets.[10] This is a substantially different company from Atlantic Southeast Airlines (ASA), which had revenue of $410 million in 1998.[11] Southwest is currently rated A- by Standard & Poor's.[12] Assuming that ASA,

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[7] Salomon Smith Barney, *The ABCs of EETCs – A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, page 37. Pages 36-47 of this report are attached as Exhibit Bra-71.

[8] *Id.*, page 46.

[9] *Id.*

[10] http://www.southwest.com/about_swa/press/factsheet.html.

[11] http://www.rati.com/airlines/AirlineFinance. 1998 is the most recent year for which information regarding ASA is publicly available.

[12] Exhibit Bra-67.

with less than one-tenth of Southwest's sales revenues,[13] was [] by EDC, this does not mean that the market would finance a sale of [] regional jets to ASA at the same rates as it would finance a sale of the same size to Southwest.

Brazil does not mean to suggest that indices for industrial bonds provide no guidance whatsoever as to the likely financing rates for particular bank-financed regional jet transactions. Indeed, Brazil showed in its statement to the second meeting of the Panel that Canada had financed several transactions at rates well below the prevailing industrial spreads. Canada has stated that over [] per cent of Bombardier's order book for regional jets was financed in this manner. These transactions would provide much better indices than the general industrial bonds.

More importantly, Canada certainly cannot pick and choose when to rely on the industrials indices. The Panel will note that whenever Canada rates a company as "investment grade" – with a rating of BBB- or better – it will use the fair market value curve because the spreads for these papers are quite low. However, when the company cannot obtain such a good rating, even under EDC's rating system, then Canada does not use the general industrials curve as its reference, since the spreads increase dramatically for "non-investment grade" issues.

Brazil notes that Canada has previously relied on EETC spreads as a conservative proxy for regional jet spreads before both the *Brazil – Aircraft* and this Panel. Thus, in *Brazil – Aircraft*, Canada has stated as recently as 4 April 2001, that:

> 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 US dollar CIRR (a 100 basis point spread over the appropriate US 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. As a result of these risk-reducing attributes, EETCs are [sic] 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 per cent of the initial fair market value, further reducing the risk profile associated with EETCs when compared to PROEX III support. In its First Submission, Canada refers to an American Airlines EETC tranche trading at 135 basis points above US Treasury rates. As the highest-rated EETC tranche for one of the highest rated US 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.[14]

The Exhibit Cda-17 to which Canada refers in the paragraph above is the same Morgan Stanley Dean Witter report that Canada submitted to this Panel as Exhibit Cda-14 to its First

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[13] Many other factors in addition to sales revenues would enter into this calculus. Brazil uses sales revenue merely to illustrate that while companies' credit ratings may be equivalent, the terms at which the companies might obtain financing may not necessarily be so.

[14] WT/DS46/RW/2, Annex I-3, Oral Statement of Canada to the Panel, para. 88 (4 April 2001) (citations omitted) (emphases added).

Submission and which Canada discussed at the first meeting of the Panel on 26 June 2001. At that Panel meeting, Canada interpreted the EETC spreads as showing that "the financing spreads required from airlines purchasing regional aircraft *far exceed* the US dollar CIRR. Even the *highest rated* US airlines, such as American, are *routinely* required to pay interest rates *significantly greater* than the CIRR."[15] Canada's analysis in this paragraph is identical to and validates the analysis Brazil provided to the Panel on 31 July 2001, just one month later.

58. What proportion of Embraer export sales of regional aircraft have not involved BNDES and / or PROEX support?

Approximately [] per cent of Embraer's export sales of regional jets to date have involved neither BNDES nor PROEX support. Brazil notes that it has not committed new PROEX support for any transactions since 18 November 1999.

59. Brazil has argued that, in considering whether or not a benefit is conferred by Canadian support, the Panel should also consider the possibility of benefit to Bombardier. To what extent is the benefit to Bombardier different from the benefit to its customers? Could there be a benefit to Bombardier in the absence of any benefit to its customers?

Yes, there could be a benefit to Bombardier even in the absence of a benefit to its customers. The Air Wisconsin transaction provides an example of how this might occur. An extremely important consideration for prospective aircraft purchasers is the monthly cost of the aircraft. In general, this cost is composed of the amount required to amortise the principle of the loan and the interest on the outstanding balance. In the large number of transactions that involve leases, the customer is faced with a required payment that usually reflects only the cost necessary to pay the financing, with the equity investors taking their reward from tax deductions against other income and the proceeds from the sale of the aircraft at the end of the lease.

Assume that both Embraer and Bombardier offer aircraft at a price of $\$\chi$, and the customer asks for financing. Embraer then offers to arrange financing at $\gamma\%$, while Bombardier is able to provide government financing at $\gamma\%$. The government support has benefited Bombardier by relieving it of the necessity of providing or arranging its own financing, even though the customer may view the offers as equal, and therefore not be benefited. If, to be more competitive, Embraer offered lower cost financing, below what the market would provide, this would be the equivalent of a price reduction, since the monthly payment would not be affected by Embraer's choice of which element to reduce – the price it asks for its product or the interest rate differential it is ready to cover. If Canada were to "match" Embraer's lower cost financing, again arguably there might be no benefit to the customer (the monthly payment is the same), but the benefit to Bombardier would be even greater, by relieving the company of having to take any action to meet Embraer's lower offer. Simply put, when Embraer offers both the goods and financing, it essentially is offering a price of $\$ \chi$ on a cash basis and $\$ \chi$ plus on a "self-financed" basis. Both prices represent Embraer's price for its aircraft. When Embraer reduces its price, it offers $\$ \chi$ minus. In contrast, when Bombardier obtains EDC support, it is able to continue to offer a price of $\$ \chi$, but is able to offer financing at γ minus %. Any financial support offered by Canada in this situation thus amounts to a pure price subsidy, enabling Bombardier to reduce its offer without having to reduce its price.

In addition, it could be argued that the purchaser may also benefit when Bombardier, with the help of EDC, "matches" Embraer's prices, because it now has an option of two suppliers instead of just one at a given cost. The purchaser can now purchase a Bombardier aircraft – not just any aircraft – with financing rates that are below those available in the market.

[15] Oral Statement of Canada, 26 June 2001, para. 14 (emphases added).

In any event, Brazil notes that this case is about Canadian subsidies that provide Bombardier with financing terms that it could not otherwise obtain in the commercial market for financing. This financing confers a benefit on Bombardier by enabling it to sell more aircraft, as in the Air Wisconsin and other transactions.[16]

60. In response to Question 25 from the Panel, Brazil asserted that it is seeking findings in respect of specific EDC / IQ transactions. Is that still Brazil's position?

Yes. Brazil has challenged three Canadian measures or programmes – EDC (Corporate Account), Canada Account, and Investissement Quebec – "as such" and "as applied." In order for Brazil to prevail on its "as applied" claims, the Panel must find that the challenged programmes have been *applied in specific transactions* in a manner that is inconsistent with the SCM Agreement. Brazil does not see how it could prevail on its "as applied" claims *without* a finding that specific transactions were financed under the challenged programmes in a manner that was inconsistent with the SCM Agreement. No matter whether this dependence of an "as applied" claim on findings regarding specific transactions is viewed as a legal or an evidentiary prerequisite to prevailing on an "as applied" challenge, the Panel must make findings regarding the specific transactions in order for Brazil to prevail on its "as applied" claim. This is especially the case here, where the challenged measures are designed to provide financing and guarantees *for specific transactions*.

Canada has suggested that Brazil has broken new ground by referring to its "as applied" claim as well as specific transactions in its submissions. Brazil disagrees, and sees its references to its "as applied" claims and specific transactions as simply reflecting the dependence of its "as applied" claims on findings regarding specific transactions as described above. Brazil's response to question 25 is consistent with this position. Indeed, Brazil suspects that, had Brazil not referred to specific transactions, Canada would have argued that Brazil had failed to satisfy the legal and evidentiary bases for an "as applied" challenge.

Brazil could have challenged a single transaction as constituting an "as applied" violation of the SCM Agreement. For example, Brazil could simply have challenged the Air Wisconsin transaction itself, without bringing any broader challenge to Canada's programmes either "as such" or "as applied." The *Norway - Procurement of Toll Collection Equipment for the City of Trondheim*[17] and *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*,[18] cases are examples of limited challenges to a single incidence of a Member's application of a particular measure. In this case, Brazil's challenge is to how the measures are applied generally, the evidence of which is found in specific transactions.

Brazil also notes that the evidence regarding particular transactions also illustrates how Canada's programmes constitute "as such" violations of the SCM Agreement. For example, information from specific transactions before the Panel shows that IQ provides guarantees backed by its A+ credit rating to [] rated companies, enabling those companies to obtain better financing terms than they would otherwise obtain, and thereby conferring a benefit on those companies.

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[16] See *Brazil – Export Financing Programme for Aircraft, Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, 10 July 2001, para. 5.28 and n. 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 that 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.") (italics in original; underlining added).

[17] GPR/DS.2/R, adopted on 13 May 1992.

[18] WT/DS126/R (25 May 1999)

61. If one assumes that the second Embraer offer to Air Wisconsin was not officially supported, and that the offer was available in the market, how would the Canada Account offer to Air Wisconsin confer a benefit on Air Wisconsin?

Canada has provided government support that it claims "matches" Embraer's offer to Air Wisconsin. However, Canada's offer to Air Wisconsin differs in a number of important respects from Embraer's offer. (*See* response to Question 56, above). To take simply one element, Canada has provided a [] per cent government equity guarantee to "match" []. Canada's is the better guarantee.

In addition, Canada's financing is for [] years with an average life of [] years, against []. Thus, Canada's official financing terms are on their face better that those offered by Embraer.

Canada claims that Embraer's offer is superior in some respects (e.g., amount financed) but the degree to which superiority in one area should be weighed against inferiority in another has not been established by Canada. Since Canada is the Member claiming these non-identical offers are equal, it is Canada's burden to prove that this is the case. When a Member provides government support to match a non-supported offer, and when those offers are not identical, it is the burden of that Member, not the complaining Member, to show that they are equal, for purposes of establishing that no benefit has been conferred.

Moreover, Canada cannot seriously argue that no benefit was conferred by Canada's offer to Air Wisconsin. First, Minister Tobin himself admitted that Canada's support to Bombardier in the Air Wisconsin transaction conferred a benefit. In his view, Embraer was "able to secure preferential, below commercial rates of interest in providing financing on the sale of aircraft, and that is something that Bombardier cannot do on its own."[19] Thus, Minister Tobin specifically stated that Canada's support to Bombardier conferred a benefit on Bombardier by providing it with something Bombardier was not able to secure on its own in the market: "What we're doing is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[20] Brazil notes that while Canada claimed in its answers to the Panel's questions to have followed a pricing methodology designed to reflect market terms, Canada does not claim to have used the same methodologies in the Air Wisconsin transaction. Canada made no effort whatsoever – other than to claim PROEX support was being given by Brazil – to determine whether or not the financing terms it was offering Air Wisconsin actually reflected commercial market terms.

Second, Canada's own statements speak to the fact that Bombardier received a benefit. Canada argues that, in case there was no Brazil government support for the Embraer offer to Air Wisconsin, all Canada did was offer terms available in the market. But Canada's argument misses the point. Bombardier was clearly not able to secure in the commercial marketplace the terms of financing it received through EDC Canada Account. As noted above, the relevant market is the market for financing terms, not the sales price at which the aircraft are available. Canada argues that no benefit was conferred on Air Wisconsin because, with EDC's support, Bombardier matched Embraer's offer. But a benefit was conferred on Bombardier because, by Canada's own admission, Bombardier was not able to obtain such terms of financing in the commercial marketplace.

[19] Exhibit Bra-21, para. 15.
[20] Exhibit Bra-21, para. 20.

Moreover, a benefit was also conferred on Air Wisconsin because, again according to Minister Tobin, Canada provided a "better rate than one would normally get on a commercial lending basis."[21]

62. The second page of the [] contained in Exhibit BRA-56 refers to []. It also refers to a []. Please confirm that [].

The []. The reference to [] refers to the [].

[21] Exhibit Bra-21, para. 66.

ANNEX A-15

RESPONSES OF BRAZIL TO ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(15 August 2001)

Additional Questions to the Parties Following the Second Meeting of the Panel

10 August 2001

Brazil

73. In Canada's answer to the Panel's question 56, with respect to repayment term, Canada argues that []. Please comment, taking into account Brazil's statement (in response to the Panel's question 56) that "[]".

Canada appears to have misread the [] that was provided as Exhibit Bra-56. While the faxed copy of the term sheet is a little difficult to read, the second page of the term sheet, under the heading "[]." Canada may have read the figure []." Nevertheless, the statement in Brazil's answer to question 56 that [].

The reference to [].

Please also explain Brazil's contention that under the Bombardier offer there would be significantly lower semi-annual payments. Please demonstrate this, assuming a loan amount of $1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, that 20 per cent of the loan amount would be [].

In its response to question 57, Brazil explained that Canada's [] with a term of [] years and an average life of [] years would result in a lower semi-annual payment than [], for the same amount financed. Brazil determined this by making a sample calculation of the monthly loan factor payable by the borrower under the various financing terms offered by the two parties. Brazil has re-produced this calculation in the worksheet attached as Exhibit Bra-72.

This worksheet shows four calculations of monthly payments based on the Panel's assumptions. Boxes 1 and 2 on the left side of the sheet show the calculation of the total average monthly payment for Embraer's offer, based on the Panel's assumptions of a total value of $1 billion, with $200 million financed as a straight loan [] at a rate of 6 per cent, and the remaining terms as per [], provided as Exhibit Bra-56. The remaining $800 million would be [].[1] The rate remains 6 per cent. This results in a average monthly payment of [] for the $200 million portion of the transaction and [] for the $800 million portion of the transaction. Thus, the total average monthly payment for the $1 billion transaction would be [].

[1] Brazil notes that the Panel's assumption of a price of $200 million [] and $800 million [] values the planes at different prices. This does not, however, affect the outcome of the Panel's hypothetical.

Boxes 3 and 4 on the right side of the sheet show the calculation of the monthly payment for Canada's terms. Box 3 shows the amount calculated for a straight loan of $1 billion, with [] per cent financed at an interest rate 6 per cent, for a term of [] years with a maximum average life of [] years. When structured as a [], this results in an average monthly payment of []. Box 4 shows the calculation when the same transaction is structured as a [], which results in an average monthly payment of []. In both cases, Canada's terms result in a significantly lower monthly payment than Embraer's offer –[] per month less in the case of Canada's [] option and [] per month less in the case of Canada's [].

Brazil calculated the amounts in Boxes 1 and 3 (the straight loan calculations) using the assumptions stated and the Excel function Goal Seek. Brazil calculated the amounts in Boxes 2 and 4 (the USLL calculations) using the Goal Seek function and, in order to determine the monthly payment factor, the ABC software programme, which generates a flow of payments that is consistent with the interest rate under the loan and the average life constraint. This software is well known in the market and is used by [] (see Exhibit Cda-70) and others.

ANNEX A-16

COMMENTS OF BRAZIL ON RESPONSES OF CANADA TO QUESTIONS AND ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(20 August 2001)

Questions to the Parties Following the Second Meeting of the Panel - 8 August 2001

Both parties

54. In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

Brazil notes that Canada has, in effect, agreed that the relevant market is the market for financing terms available to a specific borrower for similar terms and with similar security. In addition to the terms available to that borrower, however, Brazil considers that the market also includes financing terms that Bombardier has obtained in the commercial market, in the [] per cent of its transactions that did not include any government participation, for similar borrowers and similar transactions for the sale of regional aircraft.

55. If it is commercial practice to engage in transactions at a short-term loss for long-term commercial reasons, should such transactions be treated as "market" transactions? Please explain.

In paragraph 6 of its answer to this question, Canada suggests that any offer made by a private party is *per se* a "market transaction." This is unduly simplistic, in that it compels the conclusion that *no* offer can ever be "below market." This does not make sense as a matter of either logic or law, and would permit a "race to the bottom" in the field of export credits where every offer by a private entity, no matter how low, would justify yet another, lower offer by a government that was simply matching the "market" established by the previous offer by a private party. Brazil does not believe that this is the purpose of the disciplines of either the *OECD Arrangement* or, more importantly, the SCM Agreement. As the Panel in the Article 21.5 proceedings of the first *Canada – Aircraft* case noted, if "matching of derogations no matter how low the interest rate or how generous the other terms" would be permitted, "there would be no real disciplines of any kind on export credits."[1]

56. Please analyse the significant elements of Embraer's second offer, and the Canada Account / Bombardier offer, to Air Wisconsin, and indicate how the significant elements demonstrate that such offers were, or were not, comparable.

In its Response to Question 56, Canada mischaracterizes the terms of Embraer's offer to Air Wisconsin. Canada then uses this mischaracterization to summarily conclude that "Canada's financing offer was not more favourable to Air Wisconsin than Embraer's." Canada's analysis of the

[1] Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU, WT/DS70/RW (Adopted as modified by the Appellate Body 4 August 2000), para. 5.137.

Air Wisconsin transaction does not establish that Bombardier's offer, supported by the full faith and credit of the Canadian treasury, was either equal to, or less favourable than Embraer's offer.

Before turning to specific examples of Canada's mischaracterization of Embraer's offer to Air Wisconsin, Brazil wishes to address the eleventh-hour letter solicited by Canada from Air Wisconsin on 7 August 2001 (Exhibit Cda-68). It is worth noting that this letter from Air Wisconsin, which states that "the terms of the financing support" of the two offers were equally favourable contradicts a previous letter, contained in Exhibit Cda-2, which states that Canada's offer was "no more favourable than" Embraer's offer, "*viewed in its entirety*." (Emphasis added.) Embraer's offer "in its entirety," the Panel will recall, includes []. Contrary to what Canada seems to imply in section 7 of its response to Question 62 from the Panel, this [] was not part of the financing terms of the offer.

Given this apparent contradiction between the two Air Wisconsin letters, the Panel should disregard the statement in the second letter. That letter was clearly prepared at the request of Canada or Bombardier *after* Brazil pointed out that it is the financing terms of the offers, not the offers in their entirety, that matter. The letter is, therefore, of dubious evidentiary value. Brazil has previously noted that Air Wisconsin is contractually mandated to state that the terms of support provided by Canada/Bombardier were no more favourable than those offered by Embraer. As such, the Panel should view any statements by Air Wisconsin officials, including the new Exhibit Cda-68, with extreme suspicion.

Brazil now turns to examples of Canada's mischaracterization of Embraer's offer to Air Wisconsin.

Number of Aircraft

Apart from two statements by Air Wisconsin officials, discussed above, Canada has yet to produce evidence showing that an offer premised on a firm order for [] aircraft, [] Bombardier CRJ-200s, is equal to or superior to Canada/Bombardier's offer to support the purchase of [], fifty-seat CRJ-200s.

Financed Amounts

Canada asserts that Embraer's financing offer must have been superior to Canada/Bombardier's because Canada offered to finance [] per cent of the purchase price of [] fifty-seat aircraft, while Embraer offered []. Canada arrives at this conclusion by claiming that, based on these figures, Embraer offered []. This conclusion is, again, faulty.

The mere fact that Embraer may have offered [] of each aircraft while Canada "only" offered to finance [] per cent does not mean that the total amount of financing Canada supplied was somehow less than the total amount of financing offered by Embraer. The reason for this is relatively straightforward. The [] per cent financed by Canada was the result of the [] per cent equity guarantee also provided by Canada through IQ. Embraer's offer contained [].

Repayment Term

Brazil refers the Panel to the response of Brazil to Question 73 from the Panel, and Brazil's comments below on Canada's response to Question 74 from the Panel.

Interest Rate

In response to Question 56 Canada admits that it did not quite understand the interest rates that Embraer offered and that a comparison of this term cannot be made. Specifically, Canada states that it "is not clear what is meant" by "[].'" Yet Canada nevertheless concludes that the interest rate terms of both offers are equally favourable. It is worth clarifying that Embraer's offer of [].

Administration Fee

In its response to Question 56, Canada states that "Canada's offer requires payment of an up-front administration fee equal to [] per cent of the financed amount payable at the time of financing of each aircraft." Canada then intimates that, because "Embraer's offer does not include any administration or similar up front fees," in this respect, Embraer's offer was more favourable to Air Wisconsin than Canada's offer.

Brazil readily admits that [] does not contain every possible fee and term that one would normally expect to find in a contract for the sale of regional aircraft. As Brazil has previously stated, however, the reason for this is simple – Embraer did not enter into a contract to sell aircraft to Air Wisconsin, Bombardier/Canada did. Thus, it is only logical to expect that the terms of Bombardier/Canada's offer to Air Wisconsin are more fully developed than Embraer's. After all, Bombardier/Canada executed a purchase agreement with Air Wisconsin that set forth every conceivable fee and term of the arrangement. Embraer did not execute such an agreement. As Canada itself notes in its discussion under the subheading titled "Security," even though "[]," had Embraer won the sale, such provisions would have been incorporated in the final loan agreements.

Contrary to Canada's assertion, the mere fact that Embraer's offer does not refer to certain terms that likely would have been included in a final purchase agreement does not thus mean that Embraer's offer was more favourable than Canada's. Indeed, as Brazil has previously stated, when the offers are compared as whole, it is clear that Embraer and Bombardier/Canada offered Air Wisconsin different aircraft packages and different financing packages.

Security

In its discussion under the subheading titled "Security," Canada correctly notes that "[]. . . ." Canada admits, however, that had Embraer won the sale, those provisions would have been added to the final loan agreements. Not knowing what those terms would have been, Canada still somehow concludes that those terms would have been "comparable to those included in Canada's offer."

Canada assumes, without any support, that any provisions added by Embraer to the final loan agreements would have been "comparable to those included in Canada's offer." Moreover, even though Canada acknowledges that such provisions would have been included in the final loan agreements had Embraer won the sale, it makes the surprising statement that the absence of those provisions from Embraer's term sheet render Embraer's offer more favourable than Canada's.

Other Financing Support

Under the heading "Other Financing Support," Canada states that, because Bombardier/Canada's offer does not include [] in the event Embraer won the contract, in "this respect the Embraer offer is more favourable to Air Wisconsin." This argument is also flawed.

Embraer indeed offered a []. Contrary to what Canada seems to assert, however, []. Embraer, a private aircraft manufacturer, made an offer at what would likely have been a short-term loss in order to win the contract and develop a new market. What Bombardier did was resort to the Canadian

treasury to beat Embraer's offer. It did not try to beat the offer by securing better financing from a financing institution in the market or providing the financing itself. It did not offer lower financing or price reductions at its own expense. Canadian government support made it unnecessary for Bombardier to make the type of [].[2] Bombardier decided to remove any risk of losing the deal by making sure that it made an unbeatable offer with the support of the Canadian government.

Canada

66. Has the LA Encore programme used by the EDC been adapted for specific EDC considerations, or is it identical to the programme used by Lloyds Bank, Barclays Bank, and ABN-Amro?

Brazil notes that the US Comptroller of the Currency has stated that most credit scoring models are either "statistical" systems or "expert" systems.[3] A statistical system is one that relies on quantitative factors that are indicators of default, while an expert system is one that "attempts to duplicate a credit analyst's decision making."[4] The Comptroller of the Currency describes LA Encore as an "expert" type of system.[5] Thus, LA Encore requires that its operator use qualitative or subjective factors to determine credit ratings.

In its response to this question, at paragraph 5, Canada admits that EDC has customised LA Encore to take into account these qualitative or subjective factors, or to "reflect EDC's own corporate risk methodologies." Canada provides no information on how this was done other than to say that it takes into account a database of "more than 900 S&P rated industrials." Canada asserts that its customisation has been reviewed by external consultants, but Canada has still not provided any precise information regarding the subjective factors used in obtaining LA Encore ratings.

Nevertheless, based on Canada's answer, it appears that EDC does not make any attempt to consider issues particular to the aircraft sector in general, or specifically the regional aircraft sector, in developing its ratings. As Brazil explained in its response to Question 57, there are several reasons why the average spreads for general industrials may not be applicable to the regional aircraft sector. EDC's customised LA Encore system seems to eschew any consideration of those factors and, as discussed in more detail in Brazil's comments on Canada's submission of 13 August 2001, produces ratings that are completely at odds with those published by Standard & Poor's.

Brazil refers the Panel to the 20 August 2001 Comments by Brazil on Canada's Submission of 13 August 2001 for a more detailed analysis of the flaws of the LA Encore programme as used by EDC.

67. With reference to paragraph 5 of Canada's oral statement of 31 July 2001, please identify the "strong evidence" of Brazilian Government support for Embraer's offers to Air Wisconsin.

In its response to Question 67 Canada repeats previous statements relating to the evidence it allegedly has that Embraer's offer to Air Wisconsin was supported by the Brazilian government. All those previous statements and the Canadian response to Question 67 can be summarized as follows:

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[2] *See* Exhibit Bra-56 [ ]. Pursuant to Article 16 of the Panel's Working Procedures, Brazil requests that the confidential, bracketed information included in this footnote and the above paragraph be excluded from the version of the submission attached to the Panel Report.

[3] *Rating Credit Risk – Comptroller's Handbook, Section A, Assets,* Comptroller of the Currency, Administrator of National Banks, April 2001, available at http://www.occ.treas.gov/handbook/S&S.htm.

[4] Id.

[5] Id.

(i) Canada does not believe that Embraer could have provided the terms of financing it offered without support from the Brazilian government; (ii) Canada relies on statements by Air Wisconsin and Bombardier officials that Embraer "expected" to secure the support of the Brazilian government; and, (iii) Canada purports to have identified some "general pattern" of conduct by Embraer that Embraer must have followed in the Air Wisconsin transaction. None of this is "strong evidence." In fact, none of this is reliable evidence at all.

Canada itself begins its response by admitting that the "strongest evidence" of what Embraer's offer involved – [].

It is worth noting that Canada's assertions contradict its own evidence. Canada has submitted information that its own terms of financing in five transactions varied between [] and [] years and has argued that those terms did not confer a benefit.[6] Similarly, Canada has stated that "it has, on occasion, provided export credits, on commercial terms, at interest rates below the CIRR."[7] Thus, such terms are not necessarily below the market. Either way, however, Canada did not merely meet the terms of Embraer's offer: []. Nor did it merely meet the market. But even assuming, *arguendo*, that Canada did meet the terms of Embraer's offer or the market, it still conferred a benefit on Bombardier, providing to Bombardier terms that Bombardier was not able to secure by itself in the market.

Canada makes much of the [] declaration and of its new Exhibit Cda-68.[8] But all Exhibit Cda-68 claims is that Embraer allegedly said to Air Wisconsin that it "expected its offer to be supported by the Government of Brazil through BNDES." Embraer may have expected or hoped that it would get the Brazilian Government to support its offer through BNDES, but it never did get that support. As Brazil has stated, the Brazilian Government neither offered nor provided support to Embraer or Air Wisconsin for this transaction. That Embraer expected or hoped to get the support of the Brazilian Government for its Air Wisconsin offer is not "strong evidence" – and is, in fact, no evidence whatsoever – that there was support by Government of Brazil to Embraer for the Air Wisconsin transaction.

Canada relies heavily on alleged "similar offers of government support made by Brazil" in other transactions, on general statements that Embraer relied on Brazil government support, and on Embraer's "practice" of seeking and receiving government support. Brazil would like to make several points with respect to those assertions.

First, as Brazil responded to Question 58 from the Panel, approximately [] per cent of Embraer's export sales of regional jets to date have involved neither BNDES financing nor PROEX support. In addition, Brazil has not committed new PROEX support for any transactions since 18 November 1999.[9] Thus, all Canada's arguments about some "pattern," "routine," or "practice" are baseless. In [] per cent of the cases since 1995 Embraer has not relied on Brazilian Government support, whether from PROEX or from any other agency or programme.

Second, Canada speculates that, because Embraer, according to an SEC filing, does not conduct its own self-financing, and "[]," (emphasis supplied) the only other option was Brazilian

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[6] First Submission of Canada, 18 June 2001, para. 75.

[7] *Id*., para. 71.

[8] It is worth pointing out that the [] declaration (Exhibit Cda-1) where Mr.[], states that he was informed by Air Wisconsin of some particulars of Embraer's offer, contradicts the letter of Air Wisconsin (Exhibit Cda-2) stating that "Confidentiality commitments to Embraer preclude Air Wisconsin from providing more detailed information" regarding Embraer's offer. The only information contained in that letter is that Air Wisconsin valued Canada's offer as "no more favourable than that offered by Embraer, viewed in its entirety."

[9] Brazil Response to Question 58 from the Panel, 8 August 2001.

Government support. This is pure speculation on the part of Canada, not "strong evidence." Neither Brazil nor Canada can say whether or not [] was available or would have been available to Embraer, or whether Embraer would have changed its practice and made an exception in this case, where it was making an exceptional effort to capture a sale.

Canada is constructing what it refers to as "strong evidence" on the basis of the assumption that [] was not available. There is no evidence to support this assumption. In addition, Canada argues that Embraer could not have intended to finance the Air Wisconsin offer directly. As Brazil pointed out in its response to Questions 31 and 32 from the Panel, one can speculate what Embraer hoped to do or would have done, but this is certainly not "strong evidence."

Third, even if Canada's arguments about some general practice of Embraer to rely on government support had merit, this would be no more than circumstantial evidence about Brazilian government support in any specific transaction, such as the Air Wisconsin transaction. It would not be "strong" evidence.

Fourth, Canada's assertions regarding Brazilian Government support "in the context" of the campaigns for the sale of regional aircraft to SA Airlink and Japan Air Systems are factually incorrect. There was no support whatsoever from either PROEX or BNDES in the SA Airlink transaction, nor has there been any commitment for any support of any kind made to Embraer by either PROEX or BNDES in the JAS offer.

Finally, Brazil would like to make a very important, systemic point. Canada's approach to this issue in general, and Canada's response to Question 67 from the Panel, in particular, are based on Canada's assumption that Brazil bears the burden of proof that Embraer's offer to Air Wisconsin did not involve Brazilian Government support. Canada has been trying to turn the burden of proof issue in this matter upside down. The Panel should reject Canada's attempt.

The whole issue of whether Embraer's offer to Air Wisconsin involved Brazilian Government support is relevant to these proceedings only because Canada claimed, as an affirmative defence, that it matched Brazil's offer and that Canada is therefore covered by the "safe haven" of the second paragraph of item (k). Canada has the burden of establishing this affirmative defence. Canada has the burden of proving that Embraer's offer did involve Brazilian Government support, that Canada merely matched the terms of that support, and that its "matching" is consistent with the SCM Agreement.

What Canada has been doing instead is attempting to shift the burden of proof to Brazil to show that Embraer's offer to Air Wisconsin did not involve support from the Brazilian Government. For example, Canada states, in its response to Question 67, that "Brazil has offered no evidence whatsoever" for the proposition that Embraer may have made []. But Brazil does not have to offer any such evidence. All Brazil was doing was outlining some of the possible scenarios in order to illustrate that, contrary to Canada's assertion, government support was not the only option available to Embraer. Further, Canada argues that Brazil has failed to explain why "Embraer's offer to Air Wisconsin would have been any different than the practice" of Embraer to rely on some from of official government support. But Brazil, again, does not have to explain that. In fact, Brazil has stated that there may be several explanations for Embraer's strategy but has specifically pointed out that it does not know what Embraer's intentions, expectations, or hopes might have been. In fact, [].

Canada tries to shift the burden of proof to Brazil, then accuses Brazil of having failed to meet that burden, and on that basis concludes that Canada was therefore entitled to match Embraer's offer. The Panel should reject Canada's arguments. It is Canada's burden to establish that Embraer's

offer involved Brazilian Government support. Canada had to "make every effort to verify"[10] that Embraer's offer involved government support before it supposedly "matched" it, yet it did not even attempt to contact Brazil. Now, Canada essentially claims that it has made a *prima facie* case because [], and because Embraer previously "routinely" obtained Brazilian Government support. None of these assertions can withstand scrutiny. Canada, therefore, has not met its burden of proving its affirmative defence. There is no "serious" evidence that Brazil provided support to Embraer for the Air Wisconsin transaction and there can be no such evidence because Brazil neither provided nor offered support.

68. Article 25 of the IQ Act refers to "export" activities. Is the term "export" defined in the IQ Act, or in some other legislative instrument? If so, please provide the relevant material. Does the term "export" mean export outside of Québec, export outside of Canada, or both?

The term "export" is normally interpreted to refer to goods or services "sold by residents of one country to residents of another in return, usually for foreign exchange,"[11] or "to carry or send abroad."[12] Brazil understands that the Canadian courts have also interpreted "export" to refer to the transfer of goods outside Canada rather than between the Canadian provinces. Thus, the Supreme Court of Canada has stated that:

> Generally speaking, export, no doubt, involves the idea of a severance of goods from the mass of things belonging to this country with the intention of uniting them with the mass of things belonging to some foreign country. It also involves the idea of transporting the thing exported beyond the boundaries of this country with the intention of effecting that.[13]

Similarly, courts of Ontario have determined that "export" refers to "export outside Canada," stating that:

> "To export," in commercial usage, means to send out commodities of any kind from one country to another. The primary meaning of the words is "to carry out of" but one does not speak of "exporting" goods from Toronto to Montreal, for instance, although in the course of the voyage the vessel might pass outside the limits of Canada.[14]

Thus, it appears that the Canadian courts apply the standard definition of the term. Canada admits that the term is not defined in its legislative instruments. Accordingly, the Panel should assume that the standard definition prevails.

Canada's reference to Decree 572-2000, which was issued under the IQ Act, is equally unavailing. The fact that the drafters of the Decree considered it necessary to define "export" to refer to "outside Québec" in that specific Decree only suggests that the term as used elsewhere, such as in the IQ Act itself, bore its normal meaning of "outside the country."

Finally, even if "export" means only "export from Québec," as Brazil has pointed out in paragraph 129 of its Second Written Submission, a requirement of export from Québec is tantamount to a requirement of export from Canada. If a government makes part of its territory ineligible for the

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[10] 1998 *OECD Arrangement*, Article 53(a).

[11] Walter Goode, *Dictionary of Trade Policy Terms*, Centre for International Economic Studies, University of Adelaide, 2nd ed., 1998, page 103.

[12] *Black's Law Dictionary,* 5th Ed. (1979), at 520.

[13] R. v. Carling Export Brewing & Malting Company, [1930] 2 D.L.R. 725 at 733.

[14] Rex v. Gooderham and Worts Ltd., [1928] 3 D.L.R. 109.

subsidy and claims that, as a result, the subsidy is not contingent on export, many small, partial domestic eligibility designations are likely to follow rapidly. Such an outcome would be inconsistent with the letter and the spirit of the SCM Agreement.

69. Could IQ Decrees 572-2000 and 841-2000 apply in principle to financing regarding sales of Bombardier regional aircraft?

Brazil disagrees with Canada's statement that "Decree 841-2000 could not apply to financing of Bombardier regional aircraft because it applies only to small enterprises." Canada fails to support this assertion. Canada points to no provision of Decree 841-2000 restricting the application of the Decree to small enterprises only.

In fact, nothing in Decree 841-2000 suggests that its application is restricted to small enterprises. The Decree approves a "Programme for Financial Assistance to Enterprises." Section 1 of the Programme, under the rubric "Objectives," states that the objective of the Programme is to promote the economic development of Quebéc by providing financial assistance to enterprises that are engaged in commercial activities ("en accordant une aide financière aux entreprises qui exercent une activité commerciale"). There is no restriction as to the size of the enterprise.

Further, Section 2 states that the assistance is provided for the purpose, *inter alia*, of realization of investment projects, technological innovation, development of markets, etc. Again, there is no restriction relating to the size of the enterprise. Brazil also notes that the definition of the term "development of markets" (Section 10 of Annex II of the Programme) includes development of new markets outside of Quebéc, the promotion of exports to existing markets, the financing of contracts, and the provision of bank guarantees, activities that are all quite relevant to the operations of Bombardier.

On the other hand, there are provisions of the Decree suggesting that it is not restricted to small enterprises. For example, Section 19 of the Programme states that the maximum term of the financial assistance provided by Garantie-Quebéc is 10 years; however, the maximum term is 15 years with respect to *major projects for the development of markets* ("projets majeurs de développement de marchés"). It is hard to reconcile that provision with the assertion that the assistance is provided to small enterprises only.

Further, certain provisions of the Programme address situations where the amount of the financial assistance could be significant. For example, Section 30 of the Programme envisages situations where the amount of the financial assistance is over $10 million. These provisions hardly support Canada's assertion that the Decree applies to small enterprises only.

The only restriction relating to size appears in Section 8 of the Decree which restricts the financial assistance to "new economy" companies employing less than 100 persons and having an annual volume of sales of less than $10 million. "New economy" companies are defined in Section 3 of Annex II as companies operating in several sectors, including the aeronautical sector. Section 8, however, restricts the assistance to "new economy" companies but *only* with respect to the "realization of a project of a new economy." *Nothing* restricts the application of the Decree to any company of any size with respect to other activities eligible for funding, such as major projects for the development of markets, the development of new markets, the expansion of existing markets, the provision of bank guarantees, the financing of a contract, all of which are activities listed in Section 10 of Annex II.

Finally, Brazil notes that Decree 841-2000 was adopted in June 2000. Only a month earlier, Decree 594-2000, which specifically adopts a programme for the assistance to small enterprises, was

adopted.[15] It is hard to explain why, given the adoption only a month earlier of a decree that explicitly targets small enterprises, Decree 841-2000, which provides no restrictions as to the size of the recipients of the assistance, should be interpreted to apply to small enterprises only.

Canada's response with respect to Decree 572-2000 is equally unpersuasive. Decree 572-2000 promotes investment and employment in Quebéc by allowing IQ to provide financial support to encourage companies to engage in investment projects and exportation and to promote the emergence of new projects (Section 1, "Objectives"). The Decree specifically envisages financial assistance, *inter alia*, to investment projects over $10 million (Section 6(a)) and the provision of credits and loan guarantees to buyers outside of Quebéc for the purchase of goods and services. Canada admits in its response that this measure could be used to finance the sale of Bombardier aircraft but asserts that Decree 572-2000 is "not well suited for financing regional aircraft sales" because of "the Quebéc content limitation and other restrictions."

As Canada notes, the Quebéc content limitation requires that a loan guarantee does not exceed 75 per cent of the Quebéc content of the products exported. Canada does not explain, however, why this limitation makes the Decree "not well suited" to financing Canadian regional aircraft. Canada does not specify what the "other restrictions" are that make the Decree "not well suited" to financing regional aircraft. Finally, Canada states that the Decree has not been used to finance regional aircraft. While this may be so, the Decree can be used to finance regional aircraft in the future.

[15] Décret 594-2000, 17 mai 2000, Concernant la mise en place du Programme de financement des petites entreprises (Exhibit Bra-74).

70. Canada has informed the Panel that equity guarantees have been provided by engine manufacturers such as Rolls-Royce, GE, and Pratt & Whitney. Is Canada aware of other instances where equity guarantees have been provided in respect of aircraft transactions? For example, are EETCs packaged with equity guarantees? If there is no market for equity guarantees outside of IQ and engine manufacturers, how should the Panel determine whether or not the equity guarantees provided by IQ confer a benefit? Is Article 14(c) of the SCM Agreement relevant in this regard?

Canada does not directly dispute Brazil's argument, in its statement to the Panel on 31 July, that equity guarantees are not available in the market. Nor did Canada dispute that statement and provide any contrary evidence when it should have done so – in its rebuttal submission at the second meeting of the Panel. Belatedly, on 8 August, Canada submits information that it claims constitutes "clear evidence of a private sector market for the transfer of risk in a manner *similar* to the guarantees provided by IQ." (Emphasis added). According to Canada, "Financial instruments *similar* to IQ equity guarantees are, in fact, available in the market." (Emphasis added).

Canada does not, however, claim that it would be possible for Embraer to find a guarantee equal to that offered by IQ at any price. More importantly, even for what it claims are "similar" guarantees, Canada is remarkably silent on the price of those guarantees.

Canada's Exhibit Cda-74 purports to show an equity guarantee offered by a private insurer []. But this guarantee is only for [] per cent of the price of the aircraft for [] months, [], or the [] per cent for [] years that Canada provided to Air Wisconsin through IQ. Moreover, even though this was a [] transaction, Canada has deleted from the Exhibit the premium paid for the insurance. Thus, there is no way to determine how the premium charged for this guarantee compared to the apparent [] per cent premium charged by IQ.

This document, which is dated 21 February 2001, was obviously available to Canada prior to the preparation of its submission to the Panel. It is unfortunate that Canada saw fit not to submit this document as an exhibit to its first or second written submissions, as that would have given the Panel and Brazil an opportunity to discuss it at a meeting of the Panel and, perhaps, to ask Canada about the premium.

Canada claims that its Exhibit Cda-75 "shows that aircraft manufacturers can create innovative financing mechanisms centered around risk and remuneration." No doubt, but this Exhibit, too, covers only an apparent [] per cent [], and does not disclose the cost of that guarantee.

Canada's Exhibit Cda-76 consists of letters from two insurance brokers claiming that there is a well-established market for equity guarantees. But apart from their claims, they offer no evidence to contradict Brazil's Exhibit Bra-50 to the contrary, and, moreover, they do not mention premiums for the guarantees.

Finally, Brazil would note that none of these purported equity guarantees discloses the *quality* of the guarantee offered. The Panel will recall that Embraer faced two difficulties in its equity guarantee competition with Canada: (1) the fact that Canada offered a [] per cent guarantee to []; and (2) the fact that Québec's superior credit rating gave its guarantee more value to the equity investors than did Embraer's. To show that Canada merely "matched" Embraer's offer, Canada would have to prove that, for the same premium Québec received, Embraer could have [] from the market that would have been of equivalent value to the equity investors. Canada has not done so.

71. With reference to paragraph 105 of Brazil's oral statement of 31 July 2001, please clarify the dates of the Air Nostrum transaction.

Canada's clarifications have no bearing on the fact that EDC (Corporate and Canada Account) and IQ support for the Air Nostrum transaction was on terms below the market.

72. Please comment on paragraph 135 of Brazil's second written submission.

In its response to Question 72, Canada states that it "has provided all of the documentation that exists" regarding IQ's review of the Mesa, Midway, Air Littoral, Atlantic Coast Airlines, and Air Nostrum transactions. This response is highly suspect in light of the conflicting answers and documentation that Canada has produced to the Panel involving the Air Nostrum sale. Brazil asks the Panel to consider the following points.

On 29 June 2001, the Panel asked Canada, in Question 14, to "provide full details of the terms and conditions" of IQ's support for certain aircraft sales, and "all documentation regarding the review of these transactions by IQ." On 6 July 2001, Canada responded, in part, by firmly stating that IQ was only involved in the Air Nostrum deal to the extent that it provided an "'equity guarantee' of up to a maximum of [] per cent of the aircraft purchase price." However this statement conflicts with the summary of the Air Nostrum transaction that appears in Exhibit Cda-64, a document that Canada withheld until 26 July 2001.

Exhibit Cda-64 contains a chart that is titled "Détails du Financement." This chart summarizes the terms of IQ's support of the Air Nostrum deal, and indicates that Air Nostrum was to make a []. Thus, Exhibit Cda-64 indicates that, contrary to Canada's suggestion that it only provided a simple "equity guarantee," IQ actually financed a significant portion of the Air Nostrum transaction through CQC, which is, of course, jointly owned by IQ and Bombardier.

Instead of disclosing to the Panel this discrepancy, Canada now simply states that Exhibit Cda-64 "did not reflect the final terms and conditions of the guarantee provided by IQ." Instead, in response to Question 71, Canada now provides a new document, Exhibit Cda-77, dated 18 June 1998. Canada states that this document contains IQ's "final recommendation and transaction summary" for Air Nostrum. The "Détails du Financement" chart provided with Exhibit Cda-77 indicates that the percentages contained in Exhibit Cda-64 have changed. The new chart still shows that [] provided debt financing for [] per cent of the "montant financé," but the percentages have changed, and are as follows: [ ].[16] Moreover, Exhibit Cda-77 states that the separate SDI/IQ guarantee was for [] per cent, rather than [] per cent, of the transaction.

Although the percentages and terms contained in Exhibit Cda-77 differ from Exhibit Cda-64 only slightly, Brazil notes that they differ significantly from those in Canada's response to Question 14. More importantly, however, the appearance of Exhibit Cda-77 at this late stage in this dispute is extremely troubling, and casts a cloud on Canada's statement that "it has provided all of the documentation that exists regarding the review" of this and other transactions by IQ. Canada states that it "was not previously aware of the existence" of Exhibit Cda-77. If this is true, then one must question whether the documents that Canada has provided regarding IQ do, in fact, represent IQ's final recommendations for the Mesa, Midway, Air Littoral, Atlantic Coast Airlines, and Air Nostrum transactions. This is particularly true in light of Canada's initial statement in response to Question 14 that IQ only provided an "equity guarantee" to Air Nostrum. Brazil therefore asks the Panel to take adverse inferences and presume that other documents exist that show that subsidies contingent on export have been granted.

[16] That the three entities provided support in the form of debt financing is confirmed by the "[]" provision included in Exhibit Cda-77. That provision refers to support by each of the three entities as debt.

Additional Questions to the Parties Following the Second Meeting of the Panel - 15 August 2001

74. Please comment on Brazil's contention (in response to Question 56) that under the Bombardier offer there would be "significantly lower semi-annual payments" than under the Embraer offer. Please calculate the amount of semi-annual payments for both offers, assuming a loan amount of $1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, [].

Canada's answer shows that the financing terms of Embraer's offer and the offer by Bombardier/Canada are not equivalent. As Brazil understands the Panel's question, the purpose of the hypothetical is to demonstrate whether the financing terms of the two offers are different. Canada's conclusion that "it is impossible to directly compare semi-annual payments under the two offers on the basis of the Panel's assumptions" in effect is an acknowledgement of the fact that Embraer's offer and the offer by Bombardier/Canada are different. A further acknowledgement of this fact are the results of the calculations provided by [] in its model []. As Canada itself points out, the model shows "very different repayment profiles for the two offers." This completely contradicts Canada's previous position that the financing terms of the two offers are equivalent. Moreover, in its response to this Question Canada has failed to rebut Brazil's arguments that the semi-annual payments under Bombardier's offer would be significantly lower than those under Embraer's offer.

75. Relating to Canada's answer to panel question 67, is Canada of the view that the showing of the "possibility", "probability" or "expectation" of the future Brazilian government support would be sufficient to satisfy a legal element of "official support" under the OECD Arrangement in respect of "matching" provisions?

Canada acknowledges that Article 53 of the *OECD Arrangement* requires a Participant to "make every effort to verify" whether official support is involved in an offer that that Participant seeks to match. Canada did not make "every effort to verify" whether official support from the Government of Brazil was involved in Embraer's offer to Air Wisconsin. Making "every effort" would have involved actually asking Brazil. Had Canada simply asked Brazil, it would have discovered that neither Embraer nor Air Wisconsin received Brazilian government support.

Canada has stated that asking Brazil whether Brazilian official support was involved in Embraer's offer would have been futile, because "Brazil is, even today, denying its involvement in the offer to Air Wisconsin."[17] This is true. Brazil is "denying" its "involvement in the offer to Air Wisconsin" precisely because there was no involvement, and Canada has provided no evidence to the contrary. Under Canada's logic, it is entitled to make an erroneous assumption because inquiry would have revealed an unwelcome truth. The obligation to "make every effort to verify" would be empty if it only required Canada to seek verification from sources it is certain will give it the answer it wants to hear.

76. In response to panel question 67, Canada states that "it is simply not credible that []." Does this mean that Embraer offered financing terms and conditions that were not available in the "market"? If so, could Embraer's offer be used as a "market benchmark" in determining the "benefit" issue? Please explain.

In its answer to Question 76 from the Panel Canada again repeats its assertions that "Embraer's offer was to involve Brazilian government support." Canada's only actual response to the Panel's question is that "the only alternative" to Brazilian government support "however unlikely it may be, is that [] would have been arranged" which "would be, by definition, on terms available in the market." Canada does not provide any further explanation.

[17] Second Submission of Canada, 13 July 2001, para. 92.

As Brazil has explained above, in its comments to Canada's answer to Question 56 from the Panel, Embraer offered to Air Wisconsin [].[18] Moreover, in its response to Question 31 from the Panel[19] and in its Second Submission,[20] Brazil pointed out that Embraer could have [] for a variety of reasons. The point is, however, that Canada cannot show that Embraer's offer is equivalent to the market.

Canada wants to create for itself a win-win situation. Whether Embraer's offer was supported by the Brazilian government or not, Canada's position dictates that it wins: it either "matched" the offer or did not confer a benefit. Canada simply ignores the fact that, as Minister Tobin stated clearly, the Canadian treasury helped Bombardier offer terms that Bombardier could not otherwise obtain in the market.

[18] *See* Exhibit Bra-56. Pursuant to Article 16 of the Panel's Working Procedures, Brazil requests that the confidential, bracketed information included in this footnote and the above paragraph be excluded from the version of the submission attached to the Panel Report.

[19] Brazil Responses to Questions from the Panel, 6 July 2001.

[20] Second Submission of Brazil, 13 July 2001, para. 106.

ANNEX A-17

COMMENTS OF BRAZIL ON RESPONSE OF CANADA TO ORAL STATEMENT OF BRAZIL AT THE SECOND MEETING OF THE PANEL

(20 August 2001)

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I. Introduction

1. This submission contains Brazil's comments on Canada's submission of 13 August 2001, titled "Canada's Response to New Arguments in Brazil's Second Oral Statement."[1] As previously explained to the Panel, Brazil does not consider that its second oral statement, delivered on 31 July 2001, contained new arguments or information. Instead, at the second meeting of the Panel, Brazil simply applied the evidence concerning the measure of the market provided by Canada in previous statements in these and the *Brazil – Aircraft* proceedings to the information provided by Canada in its responses to the Panel's questions submitted on 26 July 2001.

2. In the short time available between the submission of Canada's data and the second meeting of the Panel, Brazil was able to construct reasonable proxies for the financing terms that would have been available in the market at the time of each of the Canadian transactions at issue. No matter which benchmark Brazil used, Canada's financing was below the market benchmark. In certain instances, Brazil also demonstrated that Canada's financing was provided at rates below the prevailing commercial interest reference rate (the "CIRR") established under the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (the "*OECD Arrangement*"). Moreover, Brazil demonstrated that the credit ratings assigned by Canada to various Bombardier customers were inconsistent with both Canada's own statements regarding the creditworthiness of airlines and the published ratings of the major credit rating agencies.

3. In its response, Canada predictably attacks Brazil's proxy benchmarks as imperfect, and continues to defend its financing practices as in accordance with commercial principles. As Brazil explains below, however, Canada has failed to justify the credit ratings it assigns to its customers, failed to show that it relies on objective estimates of the market in providing officially supported export credits, and failed to rebut Brazil's evidence that particular transactions were financed at below market rates.

4. In paragraph 5 of its response, Canada states that the pricing of aircraft financing is a "highly technical and specialised exercise, requiring both objective and subjective consideration of a large number of factors." This is undoubtedly true, but neither the complexity of the issue nor Canada's subjectivity in this exercise removes the matter from the Panel's jurisdiction. Notwithstanding the complexity of the field, there are rules that must be followed. Brazil notes that Canada is a participant in the *OECD Arrangement*, a set of rules negotiated, and incorporated into the SCM Agreement, for the express purpose of regulating this field. Brazil notes also that in challenging Brazil's PROEX programmes, at times successfully, Canada did not consider that the technical and specialised nature of aircraft financing prevented it from arguing that Brazil was providing financing below clearly discernible market benchmark rates. Moreover, Canada never suggested that Brazil's subjective consideration of the large number of factors at play was in any way relevant to the issue.

5. Canada asserts that Brazil is asking the Panel to use Brazil's judgement on these matters in place of Canada's. To the contrary, Brazil asks the Panel to use the Panel's own judgement in place of Canada's own "subjective consideration of a large number of factors" to determine whether Canada has complied with rules that it negotiated and that it has been vigilant in enforcing against Brazil. For the reasons explained below, Canada's 13 August 2001 submission fails to rebut Brazil's showing at the second meeting of the Panel that Canada has failed to follow those rules in providing official support for export financing on below market terms.

[1] Canada's submission is cited to herein as "Canada's Response" or "Canada's 13 August response."

II. Canada's Objections to Brazil's Methodology Are Misplaced

A. Brazil Simply Applied Canada's Own Methodology to EDC's Financing

6. Canada asserts that Brazil's challenge to EDC's pricing was based on "fundamentally flawed" methodologies. Despite Canada's disavowals, however, Brazil's statement at the second meeting of the Panel was based in large part on Canada's own evidence concerning the market and, moreover, accurately reflected Canada's evidence.

7. In paragraphs 21-25, Canada objects to Brazil's use of the same benchmarks previously used by Canada to challenge Brazil's PROEX II programme. As Canada notes in paragraph 22, it employed those benchmarks to demonstrate "that the rate offered under PROEX II, US Treasury plus 20 bps, was not available in the market." In paragraphs 47-50 of its 31 July statement to the Panel, Brazil used these benchmarks to demonstrate that by Canada's own measure, financing provided by EDC's Corporate and Canada Accounts, and IQ, are similarly not available on the market.

8. Canada objects to Brazil's characterization of the rates employed by Canada as indicative of the market. According to Canada, it was not using those rates in *Brazil – Aircraft* to "establish a hard limit for the international aircraft financing market."[2] This is not credible. As is illustrated in a Canadian exhibit from *Brazil – Aircraft* reproduced as Exhibit Bra-64, Canada was using financing rates secured by other airlines to demonstrate that the PROEX II T-bill + 20 bps benchmark would *always* be "massively *below* market." To do so, and to do so credibly, Canada needed to demonstrate the extent to which market financing rates would *always* be "massively" *above* T-bill + 20 bps. Canada's intent, in employing those market financing rates, was to lend credibility to its argument by showing *precisely where the market in fact is*. The Panel apparently considered Canada's argument to be both valid and persuasive, as it found that PROEX II did not comply with the "hard limit" against which Canada argued it should be measured.

9. It is entirely appropriate for Brazil now to use those same rates as one way (among several presented by Brazil in its 31 July statement to the Panel) to demonstrate that Canadian financing is below market.

10. Canada then criticizes two specific aspects of Brazil's argument. Canada first objects to Brazil's citation of Canada's statement in *Brazil – Aircraft* that representative airlines with credit ratings ranging from AAA to BBB- would have to pay spreads of up to 250 bps over US treasury. Brazil directly quoted a Canadian submission, however, which reads as follows: "in December 1999, a representative sample of airline companies operating in the US market obtained financing at T+110 to 250 basis points."[3]

11. Canada's objection appears to be with Brazil's assumption that when Canada referred to "representative" airlines, it was not referring to airlines with credit ratings ranging from AAA to BBB-. However, in stating that a "representative sample of airline companies operating in the US market obtained financing at T+110 to 250 basis points," Canada was referring to the chart now included as Exhibit Bra-64. That chart includes American Airlines, which was at that time rated BBB-, and which Canada described at the first meeting of this Panel as one of the "highest rated" US airlines. Presumably, the other airlines not among the "highest rated" would have had even higher spreads.

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[2] Canada's Response, para. 22.

[3] Brazilian 31 July statement to the Panel, para. 48, *citing Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (Adopted as modified by the Appellate Body 4 August 2000), Annex I-5, paras. 10-11.

12. Canada next states that it "did not argue that highly rated airlines would have to pay US Treasury plus 125 bps or more."[4] This is, quite simply, untrue. What Canada in fact said is even more forceful than that. Canada in fact said that the "*best rated* non-sovereign airline," which was at the time British Airways, would have to pay "US T-bill plus 105 to 120 basis points (125 to 150 for regional aircraft)."[5] Not just highly-rated airlines, but the *best-rated* airlines, would thus have to pay T-bill + 125-150 bps to finance regional aircraft. All other airlines would then have had higher spreads.

13. Canada now argues that it could not possibly have meant what it said, however, since it also argued in *Brazil-Aircraft* (again in the chart now attached as Exhibit Bra-64), that American Airlines, which was at the time rated BBB-, was paying T-bill + 111 bps.[6] According to Canada, this demonstrates that an airline rated below the "best-rated" airline would be able to obtain financing below T-bill + 125-150 bps. Canada neglects to point out, however, that the weighted average T-bill + 111 bps rate paid by American was for *large aircraft, rather than regional aircraft*. Specifically, Canada was citing financing by American for the purchase of two Boeing 777-200s, three 767-300s, and ten 737-800s.[7] Canada itself stated that financing for regional aircraft requires an additional 20-30 basis points. Thus, for the purchase of regional aircraft, American, as a BBB- rated airline, would have paid T-bill + 131-141 bps. There is, therefore, a slight inconsistency between Canada's spreads of T-bill + 125-150 bps for British Airways (rated BBB+) and of T-bill + 131-141 bps for the lower-rated American Airlines (BBB-). Notwithstanding this inconsistency, it was Canada's position that any airline that was not one of the "highest rated" airlines would have to pay spreads in excess of 150 basis points over the T-bill for regional jet financing in January 2000. Brazil notes that the industrial spreads provided in Exhibit Bra-68 indicate that the spread for a BBB- grade investment in January 2000 was approximately 160 bps over T-bill.

B. Canada Relies on EETC Spreads as Market Benchmarks

14. Canada's objections to Brazil's use of EETC spreads are equally unavailing. Canada suggests that Brazil made "exclusive use" of EETCs as a "sole benchmark" for establishing pricing for the regional aircraft industry.[8] This is surprising, given that, as Brazil has explained, Canada has itself previously relied on EETCs as a proxy for market rates for regional jet transactions.[9] Thus, on 2 March 2001, Canada told the second *Brazil – Aircraft* Article 21.5 Panel that:

> 1. 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. 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.
>
> 2. 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 US Treasury rates can range up to 500 basis points. Thus,

[4] Canada's Response, para. 24.

[5] WT/DS46/RW, Annex I-2, Rebuttal Submission Of Canada, 17 January 2000, para. 51, note 26 (emphasis added).

[6] Canada's Response, para. 24.

[7] WT/DS46/RW, Annex I-4, Responses by Canada to Questions of the Panel, 3 February 2000, Reply to Question 11.

[8] Canada's Response, para. 34.

[9] Brazil certainly did not use EETCs "exclusively" as the "sole benchmark." Brazil refers the Panel to paras. 46-61 of Brazil's Statement for the Second Meeting of the Panel, 31 July 2001, for Brazil's methodology.

> even comparing PROEX III to market rates - without taking into consideration other terms and conditions - PROEX confers a material advantage.[10]

15. The MSDW Report to which Canada refers is of course the report showing the spreads for EETCs, on which Brazil based the charts in Exhibits Bra-65 and 66. In that proceeding, Canada also stated that:

> 1. 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 US dollar CIRR (a 100 basis point spread over the appropriate US 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. As a result of these risk-reducing attributes, EETCs are tranches [sic] 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 per cent of the initial fair market value, further reducing the risk profile associated with EETCs when compared to PROEX III support. *In its First Submission, Canada refers to an American Airlines EETC tranche trading at 135 basis points above US Treasury rates. As the highest-rated EETC tranche for one of the highest rated US 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.[11]

Thus, in April of this year, Canada considered the highest-rated EETC tranche to be a "conservative relative benchmark when compared against the spreads required for financing regional aircraft." Now that its own transactions are being measured against this standard, however, Canada describes the use of this benchmark as "fundamentally flawed." Thus, in paragraph 36 of its response, Canada objects to Brazil's use of weighted average spreads for all tranches of an EETC issuance. Given that Canada has previously stated that the highest-rated tranche (with the lowest spread) was "conservative," there is no reason to believe that Brazil's use of weighted-average spreads led in any way to an unfair comparison.

16. Canada also states that Brazil used the weighted-average of all EETC issues for a particular year. However, as Brazil explained in its submission of source data, the graphs in Exhibit Bra-65 were not based on averages for a particular year, but on the spreads at which other EETCs in the market were trading in the month in which EDC offered or provided financing. By this measure, EDC's financing was consistently below the spreads at which EETCs were trading in that month. Exhibit Bra-66, provided as a cross-check,[12] took simple averages of all EETCs trading in that month, and reached similar conclusions.

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[10] Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU, WT/DS46/RW/2 (26 July 2001), Annex I-1, First Submission of Canada, 2 March 2001, paras. 78-79.

[11] WT/DS46/RW/2, Annex A-3, Oral Statement of Canada, 4 April 2001, para 88 (emphasis added).

[12] *See* Brazil's 31 July statement to the second meeting of the Panel, para. 66.

17. At the first meeting of this Panel, on 27 June 2001, Canada continued to rely on the EETC spreads to question the veracity of Brazil's statement regarding the terms of Embraer's offer to Air Wisconsin. Canada asserted that "the financing spreads generally required from airlines purchasing regional aircraft far exceed the US dollar CIRR. Even the highest rated US airlines, such as American, are routinely required to pay interest rates significantly greater than the CIRR when financing aircraft even at loan to value ratios of below 70 per cent [citing MSDW's 10 February 2001 EETC market update, Exhibit Cda-14]."[13] Again, once this analysis is applied to Canada's transactions, Canada disavows the analysis. Nevertheless, the data provided in Canada's Response continues to show that Canada provides financing at rates that do not match the standard of "significantly greater than CIRR" that Canada propounded to the Panel at the end of June. For example, in Brazil's 31 July statement, at paragraphs 73-74, Brazil noted that EDC's 26 August 1998 offer to ASA []. At paragraphs 87-88 of the same statement, Brazil noted that EDC's 12 August 1997 offer to Comair [].

18. Canada correctly notes that Brazil objected to aspects of how Canada used EETCs in the second *Brazil – Aircraft* Article 21.5 proceedings. In paragraphs 31-32 of its 13 August response, Canada quotes from Brazil's comments on Canada's responses to questions in that proceeding. But Canada does not explain the context of Brazil's quoted remarks. In the *Brazil – Aircraft* proceeding, Canada sought to show that Brazil's PROEX III programme, which permitted buydowns of interest rates to the CIRR, thereby permitted Brazil to finance at below market rates. In response to question 18 from that Panel, Canada stated as follows:

> 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 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 US airlines (American Airlines).[14]

19. Thus, Canada itself relied on the EETCs, rather than evidence of rates provided by commercial banks in other regional jet financing transactions, to determine the "commercial rates available for regional jet transactions." In particular, Canada relied on the spread achieved by the highest tranche for the highest airline. Brazil's response, in addition to the passage quoted in paragraph 31 of Canada's 13 August Response, explained that for many of the same reasons pointed out in its statement to the second meeting of this Panel and its response to Question 18, EETCs are not a perfect proxy for bank-financed regional jet transactions. In particular, Brazil pointed out that the January 2001 spread for the American Airlines transaction may not be indicative of the issuing spread at that time. In conclusion, Brazil stated as follows:

> 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

[13] Canada's 27 June statement to the first meeting of the Panel, para. 14 (bullet 2).

[14] WT/DS46/RW/2, Annex A-4, Responses by Canada to Questions of the Panel, 17 April 2001, paras. 5-6.

> basis points above the CIRR when, at the same time, its own lending to airlines *below* the CIRR is "commercial."[15]

20. This conclusion states precisely the issue before this Panel. Canada asserts here, as well as in *Brazil – Aircraft*, that its financing terms, though well below the debt of the airline with one of the highest credit ratings – are nevertheless consistent with the market. Canada cannot avoid this contradiction simply by changing its mind as to the appropriateness of the EETCs as a proxy for market rates.

21. Canada claims that in employing the market financing rates used by Canada in *Brazil – Aircraft*, Brazil has "failed to recognize that the market for the debt of these and other externally-rated airlines is dynamic," and has thus linked those rates neither "to the specifics of the EDC transactions nor to the time at which EDC made its offers."[16] To the contrary, Brazil's methods in this case were more precise than those used by Canada in *Brazil – Aircraft.* Brazil in this case attempted to compare Canada's pricing both to the contemporaneous spreads at which EETCs were trading in the month in which Canada made its commitments *and* the offering spreads at which EETCs were issued in each year. Thus, Exhibit Bra-65 compares EDC's pricing in the relevant month to the spreads at which EETCs were trading *in that month*. Brazil notes that because few or no new EETCs are issued in a given month, by using bid spreads rather than offer spreads for the comparison in Exhibit Bra-65, Brazil compared Canada's financing to a broader range of data than if Brazil attempted to rely solely on spreads for new offers.

22. Furthermore, in Exhibit Bra-66, Brazil compared EDC's pricing to the average *offer* spread for all new EETC offers in that year. Again, using an annual average spread provided a broader range of data against which to compare Canada's pricing. Moreover, by using annual averages, Brazil presumably "flattened" any spikes in spreads for particular issues and thus provided a more fair comparison for EDC's pricing. While Brazil has never claimed that either of these comparisons were statistically perfect,[17] Brazil believes that both methods of comparison are more accurate than the comparisons Canada itself made in *Brazil – Aircraft* and at the first meeting of this Panel and, more importantly, provide fair and consistent comparisons for Canada's pricing. Under both comparisons, the conclusion is stark – EDC's pricing is consistently below what the market would appear to suggest.

23. In any event, Canada's protestations that reliance on EETCs as a proxy benchmark is "fundamentally flawed" ring hollow in light of the fact that EDC itself relies on [].

C. Brazil Also Showed that EDC's Pricing Was Below General Industrial Bond Spreads

24. Brazil's Exhibit Bra-68 showed that *even assuming Canada's credit ratings to be accurate*, EDC's pricing was below the spreads at which [] were trading at the time of EDC's offer for several of the transactions discussed in Brazil's statement. Canada does not rebut these conclusions.

25. Nevertheless, Canada continues to rely extensively on the [] to justify its pricing in the worksheets provided in pages 3-10 of Annex II to its submission. Brazil has previously explained that the industrial indices represent averages of general corporate debt that are further adjusted using fair market curves that are in themselves blunt averages across a wide array of sectors and debt. At least

[15] WT/DS46/RW/2, Annex B-6, Brazil's Comments on Responses to Questions by Canada and Third Parties, para. 26.

[16] Canada's Response, para. 25.

[17] Brazil notes again that it had only two business and two weekend days to prepare its comments on Canada's data, compared to the period of 9 business days and four weekend days Canada has had to respond.

the EETCs represent actual market rates on aircraft financing secured by aircraft. In several of the worksheets (see pages 7-10) provided in Annex II, however, the [] are the only factor supporting Canada's claim that its rates are at market. If the broad averages are not considered as representative of the regional jet sector (and Canada has failed to show that they are), Canada's pricing is well below market in each of these cases.

26. Canada has also attacked Brazil for using data from one time period as a comparable for transactions from a different period. As explained above, Brazil's methodology reasonably attempted to account for time factors. Despite this attack on Brazil, Canada itself uses data from one period to justify pricing in another. For example, in Annex II, Canada relies on the [] to support *every* comparison with the exception of the Atlantic Coast Airlines February 1996 and Kendell Airlines August 1999 offers. Canada uses these [] as representative comparisons in charts covering financing offered in July 1996 (a year before the []), March 1998, August 1998, February 1999, and March 1999. This suggests that Canada is simply cherry-picking data it considers favourable to support its own position. In contrast, the advantage of Brazil's use of EETC issues is that it gave Brazil a representative sample of over 30 different issues and over 100 different tranches on which to base reasonable estimates of the market pricing.[18]

D. Canada's Attacks on Brazil's Methodology Are Contradictory

27. Canada's attacks on Brazil's methodology are also contradictory in other respects. For example, Canada states on page 1 of Annex I that there is a "large gap" between the EETC pricing and the pricing from *comparable corporate bond spreads* and the Fair Market Curve spreads" (emphasis added). However, Canada acknowledges on page 1 of Annex II that "there are not many unsecured airline corporate bonds. Moreover, to Canada's knowledge there have been *no corporate bonds issued by US regional airlines*" (emphasis added). Thus, Canada, while rejecting the use of EETC pricing, prefers instead a proxy that it acknowledges does not exist in the regional aircraft sector. Nevertheless, in justifying its pricing on a transaction-by-transaction basis on pages 3-11, Canada compares its pricing to "not many" corporate bonds in the large aircraft sector without any consideration of whether these spreads should be adjusted for the regional aircraft sector even though, as discussed above, Canada has said that spreads for the regional aircraft sector should be 20-30 points higher than in the large aircraft sector.[19]

E. EDC's Other Pricing Sources Are Also Unreliable

28. Canada rejects Brazil's criticism of other aspects of its pricing for regional jet transactions. In paragraph 14, Canada states that EDC relies on its own past pricing not to determine whether those transactions are at "market" but simply to "ensure consistency and completeness." The distinction is hollow. In either case, EDC's pricing memos show that EDC follows its own subjective assessment, rather than prevailing market practices, in setting financing terms for its transactions.

29. In its statement Brazil noted that even though Canada asserts that over [] per cent of Bombardier's sales of regional jets were financed in the commercial market without any government support, EDC does not appear to measure its pricing against the pricing for those transactions. In response, Canada states that it is difficult for EDC to obtain information regarding the terms of those transactions. This does not make sense, as Bombardier is an interested party in both the commercial and officially supported transactions. Should EDC wish to compare its financing against the financing obtained by Bombardier in the commercial market, it need only ask Bombardier for the relevant information.

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[18] *See, e.g.*, Exhibit Cda-14, which lists US airlines' EETC issues and tranches.
[19] *See* WT/DS46/RW, Annex I-2, Rebuttal Submission of Canada, 17 January 2000, para. 51 (note 26).

30. Canada attempts to argue that the "importance of the transaction to Bombardier" is relevant to establishing the market rate for a given transaction.[20] This defies belief. Brazil doubts very much that the importance of a given transaction to Embraer would ever justify the government of Brazil providing whatever support it considered necessary for Embraer to make the sale. No commercial bank would ever consider the importance of a sale to Bombardier in setting its financing terms for a transaction.

31. Furthermore, it is no defence that the [] may have been "just one of several considerations for EDC." While Canada may consider that its efforts to ensure that Bombardier prevails in transactions that are important to it are, in Canada's own words, "just one" of the " subjective considerations" on which, again in Canada's words, it should not be "second guess[ed]," the issue before the Panel is whether EDC's financing was based on commercial market principles and terms.[21] The [] cannot possibly be construed as either a commercial market principle or term.

III. Canada's Methodology to Assign Credit Ratings Is Unreliable and Overstates Ratings

32. Canada's submission fails to justify either the manner in which EDC assigns credit ratings to borrowers or the actual ratings it has assigned. In its statement to the second meeting of the Panel, Brazil showed that the ratings assigned by Canada to various borrowers were consistently higher than the ratings published for better, more credit worthy airlines. Moreover, Brazil also showed that Canada's ratings for particular airlines frequently changed for no apparent reason, and seemed to be post hoc rationalisations for particular financing spreads.

33. In its 13 August response, Canada makes little effort to justify the credit ratings on which its financing terms are based, devoting only a single page of its submission to the issue. Canada attempts to defend its LA Encore system, but, as explained below, that system has no value as an independent or objective means to determine whether Canada's financing terms are at market. Canada simply assumes that the credit ratings it assigns to various airlines are valid, and, based on these ratings, attempts to justify the terms of its financing. However, the accuracy of the credit rating assigned to a borrower is crucial to determining the appropriate financing rate for that borrower. If Canada assigns a better credit rating to a company than the market would, then presumptively any financing provided on the basis of that rating is also better than the market would provide.

A. LA Encore Is Wholly Unreliable as An Objective Tool

34. In its response to the Panel's question 66, Canada acknowledged that its LA Encore ratings system has been customised to use subjective factors. While Canada asserts that it provided additional documentation regarding LA Encore in its response to question 66 that establishes the programme's reliability, Brazil notes that Canada has not provided any information regarding the precise manner in which EDC has customised LA Encore or any description of the subjective factors used in the programme. Moreover, such information as Canada has placed on the record regarding LA Encore shows that the programme, as used by EDC, is totally unreliable for the purpose of verifying whether Canada's financing was at market rates.

35. For example, Canada acknowledges that LA Encore underwent a "recalibration of specific weighting," but does not explain how this was done. All that Brazil and the Panel know, for a fact, is that this recalibration upgraded previous ratings given by EDC itself by up to [].[22] The flexibility and customisation of LA Encore seems to be one of the main characteristics of the software. Canada's Exhibit 72 refers repeatedly to the manner in which the software may be customised. According to

[20] Canada's Response, para. 26-28.
[21] Canada's Response, paras. 28, 3, and 5, respectively.
[22] Brazil's 31 July statement to the second meeting of the Panel, para. 54.

that Exhibit, the software has "customisation tools" that allow the user to establish its "own credit practices, policy guidelines or internal ratings approach." Further, "[a] powerful set of support tools *makes customisation possible at every level*…" (emphasis added). In fact, the customisation of results is ensured, inter alia, by a "tuner," that allows the user to "reconfigure subjective questions and adjust their impacts throughout the assessment network."[23]

36. Canada's Exhibit 73 provides further evidence of the lack of objectivity of the software. Sections 3.2 and 3.2.1 describe in detail how the user may establish its own "weight rule" and assign different weights to the various parameters it has selected to be examined. Again, Canada has provided no information as to how its own "weight rules" actually work. In fact, this software is so easy to customise that the results obtained with the programme are actually meaningless to anyone outside the institution that uses it. In the words of the expert cited by Canada, Mr. Kumra, "this flexibility generally precludes the outputs of the system from being used outside the organization. The very attributes that allow extensive customization of the knowledge base for specific credit environments prevent two organizations from being able to *objectively* use the measure as a basis for transactions since they cannot use the (differently) customized systems as a common basis for comparison."[24]

37. According to Canada's own exhibits, the LA Encore results obtained by EDC reflect EDC's own methodologies, its own culture, and the risk appetite of an official export credit agency. None of these factors is dependent on the commercial market for financing terms for regional jet transactions. It is no wonder, therefore, that EDC's use of LA Encore can improve the credit rating of an airline company by []. In these circumstances, the Panel should not consider EDC's use of its customised software as in any way supportive of Canada's claim that EDC finances at market rates. The Panel should not only consider particular transactions financed through EDC as violations of the SCM Agreement. It should also hold that EDC's use of the "market window" as such is a violation because the whole "market window" concept is based on significantly inflated credit ratings of the borrowers.

B. EDC's Credit Ratings for Its Customers Are Vastly Overstated

38. In addition to, and because of, LA Encore's fundamental unreliability and subjectivity, the credit ratings assigned by EDC to its various customers are much better than agencies such as Standard & Poor's normally assigns to the airline industry. An analysis of EDC's ratings shows that EDC's customers consistently get better ratings than *all* airlines rated by Standard & Poor's, with the exception of British Airways (described by Canada in *Brazil – Aircraft* as the "best rated non-sovereign airline"), Southwest Airlines (considered to be the best managed large airline in the United States), and, in some instances, American Airlines (described by Canada at the first meeting of this Panel as one of the "highest rated" US airlines). Canada's Response makes no effort to show how its ratings bear any relationship to the published ratings for the airline industry. As noted above, overstating a customer's credit rating enables EDC to provide financing at spreads that may not be available based on an inferior credit rating.

39. The extent to which Canada overstates credit ratings may be seen from the chart attached as Exhibit Bra-73. This chart shows a comparison between the credit ratings assigned by EDC to various customers, taken from Canada's submission, and the ratings given by Standard & Poor's to various commercial airlines at the time of each EDC transaction. In the right hand columns of this chart, Brazil has calculated the difference in number of notches between the ratings provided by

[23] Exhibit Cda-72, page 3.

[24] Exhibit Cda-73, page 16-17 (emphasis added). In addition, according to the same expert, part of LA Encore's "power derives from its extreme flexibility which allows users to directly modify the underwriting models that are used by the system by augmenting the KB with additional rules or by adjusting the weightings within the existing knowledge base." *Id.*, page 14.

Canada (using the ratings for both secured and unsecured debt) and the ratings published by Standard & Poor's for the relevant date.[25] A "+" symbol in the columns headed "Difference" indicates the number of notches by which EDC's customer has a *better* credit rating than the published Standard & Poor's airline for each company. A "-" symbol in those columns indicates the number of notches by which EDC's customer has a *worse* credit rating than the Standard & Poor's rating.

40. This analysis shows that, for example, Canada rated Atlantic Southeast Airlines (ASA) [], in August 1998. In March 1997, Canada rated ASA []. ASA's rating in both cases was []. The significance of this rating can be seen by reference to the spreads for [] for August 1998, provided in Exhibit Bra-68. The first page of this exhibit shows that the spread for an [] with the rating of [] (unsecured) [] was approximately [] bps above the 10-year US T-bill. The spread for [ ] with the rating of [] assigned by Standard & Poor's to American, in contrast, was over [] bps above the 10-year T-bill. Nothing in Canada's response comes even close to justifying these differences, or explaining how or why ASA came to have []. Nevertheless, Canada uses these ratings to provide terms to EDC customers such as ASA that would not apparently be available to Standard & Poor's highest-rated airlines. Canada uses these inflated ratings, in other words, to release EDC from the requirements of the *OECD Arrangement* and to justify its foray into "market window" financing.

41. The story is the same for EDC's other customers. In both March 1998 and February 1999, for example, EDC gave Comair a [].[26] Again, Canada has provided no explanation of why Comair merited []. However, the materials provided by Canada in Annex II to its 13 August 2001 submission illustrate the extent to which Canada's argument depends on these ratings. Page 10 of Annex II shows Canada's comparisons for Comair's February 1999 pricing of T-bill plus [] basis points, and states this was "well above" the market, including bond issues and the []. This may be so only if it is assumed that Comair's rating of [ ] is reasonable. If Comair were given the [].

42. The same contrast exists on page 9 of Annex II. This analysis gives Canada's comparisons for Comair's March 1998 pricing of T-bill plus [] basis points, which Canada claims was "within" market for that period. However, page 9 indicates that EDC's pricing was below all of the comparables Canada itself uses, except for []. Again, if Comair were given the same rating as [], EDC's pricing would be [] in addition to the other indices on which Canada relies.

43. The same analysis holds true for all of the customers for whom Canada has provided information in its 13 August 2001 submission, with the possible exception of Kendell.[27] For [], all the evidence indicates that the credit ratings for these companies are simply not consistent with credit ratings for other airlines in the market, and therefore are simply not a reliable market-consistent basis on which to determine market spreads for financing for these customers.

44. Finally, Brazil notes also that Canada's ratings are much better than the ratings Canada itself has said are normally found in the airline industry. In *Brazil – Aircraft*, Canada noted that as of January 2001, *no* airline had an "A" rating.[28] Yet, as shown in attached Exhibit Bra-73, [].

IV. Specific Transactions

[25] The Standard & Poor's ratings were provided in Exhibit Bra-67.

[26] Comair's rating of [].

[27] Kendell is the only EDC customer in this analysis that obtained a []. Given that the Kendell transaction [], the credit rating assigned by EDC to Kendell may be said to be consistent with Standard & Poor's ratings. Rather than justifying EDC's practices, however, this further illustrates the anomalies in EDC's ratings of []. Brazil's comments regarding the specifics of the Kendell transaction are provided below.

[28] WT/DS46/RW/2, para. 5.36, n. 51.

45. Brazil has shown that Canada's response fails to rebut Brazil's allegations regarding the systemic manner in which Canada fails to adhere to market benchmarks in determining either credit ratings or spreads for particular transactions. In addition to these systemic issues and the specific ratings and spreads already discussed, Brazil has the following additional comments regarding the transactions discussed in Brazil's statement to the second Panel meeting and Canada's Response thereto. Brazil notes that these comments are limited to rebutting the arguments in Canada's Response. They are not comprehensive but complementary to the comments made in previous submissions and statements by Brazil.

A. Atlantic Southeast Airlines

46. Brazil notes that while Canada provided pricing memos for the Comair and Kendell transactions, it never did so for the ASA transaction. Thus, when Canada refers in Annex II of its August 13 response to the different benchmarks EDC used to price the ASA transaction, the Panel has no way of knowing whether those were the actual benchmarks EDC used to price the transaction, or whether, instead, Canada searched for the specific purpose of this dispute for any benchmark that falls below the rates it offered ASA.

B. Atlantic Coast Airlines

47. On page 5 of Annex II, Canada defends its pricing of offers to EDC in part on the ground that one of its offers was ultimately not accepted by ACA. Brazil notes that whether or not EDC's early offers were accepted, EDC appears to have relied on its February 1996 offer to ACA in pricing EDC support for the Comair transaction. The chart on page 5 of Exhibit Cda-59 specifically refers to the February 1996 offer to ACA as an example of "past EDC pricing to US airlines." Thus, these offers provide further evidence that EDC does not follow market principles.

48. Brazil also notes that, as with the ASA transaction, Canada never provided pricing memos for the ACA transaction. Brazil's comments above with respect to the ASA transaction are therefore also relevant to the ACA transaction.

C. Air Nostrum

49. Brazil notes that Air Nostrum received [] loan from Canada Account, as well as []. As Brazil pointed out earlier, the weighted average of [].[29] In addition, Air Nostrum received a [] per cent equity guarantee provided through IQ. In its separate comments on Canada's 8 August response to question 72, Brazil has addressed Exhibit Cda-77, and what Canada now states are different terms for the Air Nostrum transaction. For example, Exhibit Cda-77 indicates that IQ provided a [] per cent guarantee to Air Nostrum, rather than a [] per cent guarantee, as Canada previously stated. In any event, the terms in Exhibit Cda-77 (as with those in Exhibit Cda-64 before it), have been demonstrated elsewhere by Brazil not to be market terms of financing.[30]

50. Canada alleges, in paragraphs 100-103 of its 13 August response, that it was matching terms offered by the Brazilian government to Air Nostrum. The Panel has twice requested "all documentation regarding the review" of IQ transactions, including the Air Nostrum transaction.[31] Canada failed to provide information about this alleged "match" in response to either request from the Panel. It is unfortunate that Canada has chosen now, at this late date, to make this allegation. In any event, Canada's "matching" defence – which Brazil assumes to be recourse to the safe haven of item (k) – must fail. Canada has not provided *any* documentary evidence supporting its claim; nor has it

[29] *See* Brazil's 31 July statement to the second meeting of the Panel, para. 109 and Exhibit Cda-64.
[30] *See*, *e.g.*, *Id.*, paras. 105-113.
[31] *See* Questions 14 and 41 from the Panel.

demonstrated that it actually matched competing terms. Even on 8 August, when it provided, in Exhibit Cda-77, a revised version of the documentation regarding Canadian government support for Air Nostrum, Canada failed to provide any documentary information supporting its alleged match. Moreover, as the Panel is aware, Brazil does not consider that recourse to matching maintains "conformity with" the interest rates provisions of the *OECD Arrangement*.

D. Kendell Airlines

51. Canada suggests that because commercial banks joined EDC in financing the Kendell transaction, this transaction must be considered as "by definition" a commercial transaction. This argument is flawed, for two reasons. First, the fact that EDC provided part – a large part – of the financing means that this is an officially supported transaction, not a commercial market transaction. Second, Canada asserts, without support, that EDC was a price taker not a price maker in this transaction. Given that EDC enjoys the highest possible credit rating, EDC's presence in the deal necessarily affected the financing terms. Whether EDC was the chicken or the egg in establishing the financing terms for this deal, the fact remains that this was an officially supported transaction, the terms of which were necessarily affected by the support of a AAA-rated ECA.

52. Brazil also notes that Canada accepts on page 11 of Annex II that the terms of the Kendell transaction were lower than the industrial curves would indicate.[32] Canada's defence is that the pricing was "driven" by the commercial banks. As noted above, there is no support for this assertion. Canada describes the Kendell transaction as "evidence that the commercial market can *in some circumstances* provide financing more competitive than certain benchmarks."[33] Canada does not appear to realise that the "circumstances" present in the Kendell transaction that enable the financing to be "more competitive than certain benchmarks" are no more than the involvement in the transaction of a major government export credit agency with a AAA rating. Whether or not EDC itself actually drafted the proposed terms, the reality is that its involvement means that this is not a commercial transaction, and does not provide a benchmark against which other transactions that are officially supported in whole or in part may be measured.

53. Brazil notes that Canada continues to assert that EDC participated in this transaction on a *pari passu* basis. In addition, Brazil notes that in its statement at the second meeting of the Panel, Canada asserted that EDC provided financing for [] per cent, rather than [] per cent of this transaction. Given that four other banks in addition to EDC participated in this transaction, it is not clear how EDC could have financed [] per cent of the deal and still been on precisely the same terms as the other four banks. Moreover, Canada's assertion that EDC only financed [] per cent of the transaction is inconsistent with the pricing strategy included in Exhibit Cda-39, which states that "[i]t is anticipated that EDC will fund up to [] per cent of the notes while [] together with 3 other identified underwriters, will hold the other [] per cent." Canada has failed to resolve this inconsistency.

54. Brazil also notes that even though Canada stated at the second meeting of the Panel[34] that only four banks participated in the Kendell transaction, on page 11 of Annex II, Canada continues to list seven banks as involved in the transaction.

V. Investissement Québec

[32] As noted above, the Kendell transaction is the only situation in which EDC's credit rating of the borrower seems to be in line with the ratings given by the commercial rating agencies. This may be a result of the presence of other commercial banks in the transaction and the resultant pressure on EDC in this instance to conform better to market practices.

[33] Canada's Response, Annex II, page 11 (emphasis added).

[34] Canada's 31 July statement to the second meeting of the Panel, para. 49.

55. Canada makes several assertions with respect to IQ support. First, although it continues to insist, in paragraph 111 of its submission, that IQ charges fees for its guarantees, it has provided no evidence of those fees whatsoever with respect to the Air Wisconsin transaction. In fact, Canada has failed altogether to provide documentation for the IQ guarantee to Air Wisconsin similar to that provided in Exhibits Cda-60 through Cda-64 for IQ guarantees to other Bombardier customers. With respect to other transactions for which Canada has shown evidence of a fee,[35] it has only shown the [] basis point "up-front fee," and not the [] basis point "annual fee" Canada claims is also charged.

56. Whether IQ charges no fees, a [] basis point up-front fee, or an additional [] basis point annual fee, however, is irrelevant, unless Canada can demonstrate that those fees are commensurate with what a commercial guarantor with an A+ credit rating would charge. An IQ guarantee, backed by Québec's A+ credit rating, confers a benefit by allowing Bombardier or its customers to secure better financing or to make equity participation more attractive than in the absence of that guarantee. Since Canada has defended IQ guarantees by asserting that IQ charges "market" fees, it is Canada's burden to prove as much.[36] Canada has not done so.

57. Second, Canada claims that the Midway transaction, which involved an IQ equity guarantee, does not also include financing support from CQC. This is not credible. The "Détails du Financement" chart included with Exhibit Cda-61 indicates that [] per cent of the "montant maximal financé" for the Midway transaction came *via* an EETC, with the remaining [] per cent coming from CQC. The "Sommaire de transaction" also included in Exhibit Cda-61 states that the transaction was composed of [] per cent debt and [] per cent equity, corresponding to the [] EETC-CQC split discussed in the "Détails du Financement" chart. Canada has not provided full information regarding the terms of the CQC equity support for this transaction, despite the fact that the Panel has twice asked it to do so.[37] Brazil therefore requests that the Panel adopt adverse inferences, and presume that the information regarding CQC's equity support for the Midway transaction, if provided, would demonstrate export subsidization.

58. Separately, the "Sommaire de transaction" page states that [] per cent of that "montant financé" was subject to a guarantee, which is presumably the [] per cent equity guarantee discussed by Canada in its response to Question 14.

59. Exactly the same terms appear in Exhibit Cda-63, concerning the Atlantic Coast Airlines transaction. The "Détails du Financement" chart included with that exhibit indicates that [] per cent of the "montant financé" for the Midway transaction was financed as debt from an unspecified creditor, with the remaining [] per cent coming from CQC. The "Sommaire de transaction" also included in the exhibit states that the transaction was composed of [] per cent debt and [] per cent equity, corresponding to the [] Unnamed Creditor-CQC split discussed in the "Détails du Financement" chart. Once again, Brazil notes that Canada has not provided full information regarding the terms of the CQC equity support for this transaction, despite the fact that the Panel has twice asked it to do so.[38] Brazil again requests that the Panel adopt adverse inferences, and presume that the information regarding CQC's equity support for the ACA transaction, if provided, would demonstrate export subsidization.

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[35] *See* Exhibits Cda-60 through Cda-64.

[36] *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R (23 May 1997), pg. 16 ("International tribunals, including the ICJ, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof.").

[37] *See* Questions 14 and 41 from the Panel.

[38] *See* Questions 14 and 41 from the Panel.

60. Brazil notes that Canada does *not* deny that CQC provided debt financing support for the Air Nostrum transaction. As noted in paragraphs 106 of Brazil's 31 July statement for the second meeting of the Panel, the "Détails du Financement" chart included with Exhibit Cda-64 indicates that after Air Nostrum's []. The "Sommaire de transaction" included in the same Canadian exhibit states that SDI (now IQ) further guaranteed [] per cent of that "montant financé." With its new Exhibit Cda-77, discussed in more detail in Brazil's comments on Canada's 8 August response to question 72, Canada now states that Canadian government support came in the form of debt financing, with [].

61. Third, in paragraph 112 of its submission, Canada again resorts to the impact of alleged [], this time to rebut Brazil's claim that charging the same fee to recipients of IQ guarantees with varying credit ratings is inconsistent with market practices. According to Canada, [], IQ's risk that any particular purchaser will default is spread across the portfolio of all transactions. [].

62. Even assuming, *arguendo*, [] Canada's argument is without merit. [] and the way in which it [], may very well "greatly diminish" IQ's risk exposure, as Canada argued in its response to question 47. However, as Canada itself emphasized in its response to question 48, []. Those []. When an aircraft purchaser goes to a lender or looks for equity investors with an IQ guarantee, the lender or the investors see the full [] per cent guarantee backed by the superior, A+ credit rating of the Government of Québec. Whatever the effect of a [], Québec's A+ rating confers a benefit on the lower-rated purchasers receiving IQ guarantees, by allowing them to secure more favourable terms for debt or equity.[39] Moreover, charging the same fee for this benefit, regardless of the purchaser's credit rating, is not market-based.

63. Brazil also notes that []. The alleged []. Thus, IQ's risk exposure is not diminished with respect to the remaining [] per cent of its guarantee. Moreover, Finally, [] appear only to apply to IQ equity guarantees, and not IQ loan guarantees.

VI. Conclusion

64. Using Canada's own data and Canada's own methodology, Brazil was able to show that Canada's financing through the challenged programmes is below the market. Canada's attacks against Brazil's data and methodology are therefore groundless. Moreover, Canada has not been able to justify the credit ratings it assigns to its customers and has failed to show that it relies on objective estimates of the market in providing government support. Canada's 13 August response, therefore, fails to rebut Brazil's showing that Canada provides export financing support on below market terms.

[39] *See* paragraph 143 of Brazil's 13 July rebuttal submission, and paragraphs 14-15 of Brazil's 31 July statement for the second meeting of the Panel.

ANNEX A-18

COMMENTS OF BRAZIL ON INTERIM REPORT OF THE PANEL

(26 October 2001)

Brazil thanks the Panel and the Secretariat for their efforts in producing the Panel's interim report, dated 19 October 2001. Brazil is not requesting an additional meeting to discuss the interim report, but asks the Panel to consider the following comments:

1. Paragraph 7.18. Brazil notes a typographical error in the first sentence:

> ". . . we view the claims in this proceeding to be different and broader than those that were the subject of the *Canada – Aircraft* ruling."

2. Paragraph 7.106. Brazil notes some typographical errors in this paragraph:

> "Leaving aside for the moment the issue of export contingency, we first address that of subsidization, in particular, whether ~~Canada~~ the Corporate Account mandates the conferral of benefits within the meaning of Article 1 of the SCM Agreement."

3. Paragraph 7.147. The Panel states that United Express is operated by Air Wisconsin. It would be more accurate to state that Air Wisconsin operates as United Express.[1]

4. Paragraph 7.221. Brazil believes that the Panel has misconstrued Brazil's argument in this paragraph. Referring to paragraph 15 of the Comments of Brazil on Responses of Canada to Questions from the Panel Following the Second Meeting of the Panel, 20 August 2001, the Panel states that Brazil purported to "use EETC data in the same manner as Canada used it [in the *Brazil – Aircraft – Second Article 21.5* proceeding]." However, nothing in paragraph 15 suggests that Brazil claimed that it was using the EETC data in exactly the same manner as Canada did in the *Second Article 21.5* proceeding. To the contrary, paragraph 15 states that since Canada considered the highest rated tranche of an EETC to be a conservative benchmark, there was no reason to believe that Brazil's use of weighted-average spreads – rather than a "conservative" spread – would provide an unfair comparison against which to measure EDC financing. In paragraph 15, Brazil quoted directly from Canada's submission in the *Brazil – Aircraft – Second Article 21.5* proceeding, without ever suggesting that Canada used weighted-average spreads in that phase of the *Brazil – Aircraft* proceedings. Several other statements by Brazil make clear that it did not "purport[] to use EETC data in the same manner as Canada." For example, Brazil explained, in paragraphs 19-22 of its 20 August 2001 submission, that it used the EETC data in several different ways in order to provide "fair and consistent comparisons" for Canada's pricing. Brazil notes, however, that it would be inaccurate for the Panel to imply that Canada has never previously used weighted average EETC spreads as a benchmark. Brazil's Exhibit Bra-64 shows that Canada in fact used weighted average spreads in the *Brazil – Aircraft – First Article 21.5* proceeding.[2]

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[1] *See* http://www.airwis.com/

[2] Exhibit Bra-64 is a chart used by Canada in the first *Brazil – Aircraft* Article 21.5 proceeding, which shows weighted-average spreads for EETCs issued by various airlines.

5. Paragraph 7.226. The Panel states that it is "unrealistic" to expect EDC to have access to data regarding the [] per cent of Bombardier sales not receiving EDC support, since EDC was not party to those transactions. Brazil requests that the Panel add the following footnote, after the final sentence of the paragraph:

> "We note, however, that Brazil was able to comply with the Panel's requests to provide details, [], regarding Embraer's offer to Air Wisconsin, although Brazil was not a party to that offer. *See* attachment to Brazil's letter of 25 June 2001 to the Panel. *See also* Response of Brazil to Question 33 and Exhibit BRA-56".

6. Paragraph 7.231. There appears to be a typographical error in the sixth sentence of this paragraph:

> We find it difficult to accept that the existence of "benefit" (in the context of financing) is ~~not~~ determined on the basis of whether or not Bombardier provides internal or external financing.

7. Paragraph 7.232. The third sentence appears to include a typographical error. It should begin with "EDC," rather than "ASA."

8. Paragraph 7.294 (footnote 244). The second sentence of footnote 244 includes a typographical error. The reference should be to "Exhibit CAN-58."

9. Paragraph 7.304 (footnote 249). Footnote 249 appears to include several typographical errors.

10. Paragraph 7.352 (footnote 278). The Panel states that Exhibit CAN-61 does not indicate the existence of IQ financing to Midway. However, as Brazil noted in paragraphs 57-58 of its 20 August submission, the "Détails du Financement" chart included with Exhibit CAN-61 indicates that [] per cent of the "montant maximal financé" for the Midway transaction came *via* an EETC, with the remaining [] per cent coming from CQC. This corresponds to the indication in the "Sommaire de transaction" that the transaction was composed of [] per cent debt and [] per cent equity. The [] per cent CQC equity *guarantee* mentioned in the "Sommaire de transaction" is different from CQC's [] per cent equity *participation* in the transaction. Canada has denied that CQC provided "financing" to Midway; it has not denied that CQC participated in the transaction as an equity investor.

The Panel requested Canada to provide "full details of the terms and conditions" of IQ support, and "all documentation regarding the review" of IQ transactions.[3] Canada only provided information regarding the details of CQC's [] per cent equity *guarantee* for the Midway transaction, and not details of CQC's [] per cent equity *participation*. This is the reason for Brazil's request that the Panel adopt adverse inferences.

[3] *See* Questions 14 and 41 from the Panel.

ANNEX A-19

COMMENTS OF BRAZIL ON COMMENTS OF CANADA ON INTERIM REPORT OF THE PANEL

(2 November 2001)

Paragraph 7.18

In its comment to Paragraph 7.18, Canada states that the legal framework under which the Canada Account is operated has "not changed."

Brazil notes that the legal framework under which the Canada Account operates has, in fact, changed since the Panel's decision in the first *Canada - Aircraft* dispute. As a result of that Panel's ruling, Canada enacted a policy memorandum stating that Canada Account support would respect the terms of the *OECD Arrangement*. The Article 21.5 proceedings in that dispute centered on this policy memorandum. Although the Article 21.5 *Canada - Aircraft* Panel found that this policy memorandum did not bring Canada Account into consistency with its obligations under the SCM Agreement, this memorandum is apparently still in effect. Canada provided a copy of the memorandum to this Panel as Exhibit Cda – 50. The Panel should therefore reject Canada's comment.

Paragraph 7.145

Canada's comment to Paragraph 7.145 states that, "In the last sentence, '… Canada assumes that because the Embraer offer was not supported by the Brazilian Government …' should be changed to '…Canada assumes that if the Embraer offer was not supported by the Brazilian Government …'. This would more accurately reflect Canada's argument, which was made in the alternative to Canada's principal position that Embraer's offer was supported by the Brazilian Government."

Brazil objects to this comment and the proposed amendment. In the preceding paragraphs the Panel discusses Canada's argument that Canada had "matched" Brazil's offer in compliance with the *OECD Arrangement*. In paragraph 7.145 the Panel refers to Canada's argument in the alternative: that because Canada's offer was extended on the same terms as Embraer's offer, Canada's offer was market-based. The purpose of the last sentence of paragraph 7.145 is thus not to reflect Canada's doubts on whether Embraer's offer was realistic without the support of Brazil. The word "because" is there to show a cause and effect relationship, a causal link. The point of that sentence is that Canada assumes that an offer not supported by the government is, for that reason alone, market-based. The Panel should therefore reject Canada's comment.

Paragraph 7.152 & 7.316

In its comment to Paragraph 7.152 and Paragraph 7.316, Canada states that, "It is not correct that Canada Account (or Corporate Account) financing is only available for export transactions." Canada now claims that EDC may enter into "'domestic financial transactions' .

. . provided that in doing so, EDC is supporting and developing . . . Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."

Brazil objects to this comment and notes that Canada chose not to make this argument to the Panel, despite having had ample opportunity to do so. Because Canada has waited until after the release of the Interim Report to present this claim, there is no information in the record supporting Canada's assertion. Throughout the course of this proceeding, Canada has constantly reminded the Panel of the importance of respecting a Member's right to due process. Because Canada's claim regarding EDC's alleged domestic support was not previously raised, Brazil did not have an opportunity to fully litigate the issue before the Panel. Consequently, Brazil's due process rights would be severely compromised if the Panel were to alter the Interim Report to reflect Canada's belated claim. In any event, even if the Panel were to consider this argument (which it should not), the *proviso* in the last sentence of Canada's comment proves that the Canada Account and Corporate Account can only be used to support and develop Canada's export trade. The Panel should therefore reject Canada's comment.

Paragraph 7.218, Footnote 177 & Paragraph 7.221, Footnote 179

Canada's comment to these footnotes states that, "The reference should be to Comments of Brazil on Canada's Response to New Arguments in Brazil's Second Oral Statement."

Brazil notes that this statement is incorrect. Brazil never submitted a document with this title to the Panel. Brazil did not consider that the information it presented at the Second Meeting of the Panel contained "new" arguments. The reference should therefore be to "Comments by Brazil on Canada's Submission of 13 August 2001," paragraph 15.

Paragraph 7.276

Canada's comment to Paragraph 7.276 states that, "On the basis of the [], the Panel has concluded, incorrectly, that EDC financing [] does not include []. To clarify, the [] provides that [] will include[]. The [] further allows for the lowering of the fixed margin for credit risk identified in the [] on the authority of the President or Senior Vice President Finance and Chief Financial Officer. Thus, an authorized margin below the identified fixed margin is the [] for that transaction."

Brazil objects to this comment. The Panel found, correctly in Brazil's view, that EDC's [] would approximate the rate a commercial lender would seek, and that rates [] were indicative of a benefit, absent evidence to the contrary. Canada now argues that because EDC officials may authorize rates [], those rates are "appropriate." Brazil disagrees. The mere fact that someone at EDC authorizes a rate [] does not in any way establish that the rate is in any way "appropriate" when measured against commercial rates. The "fixed margin" built into the [] presumably reflects the "commercial principles" upon which Canada has insisted EDC operates. The Panel is entitled to presume that anything [] does not reflect those same commercial principles.

In any event, Canada has not, either prior to issuance of the Panel's interim report or in its comments on that report, provided any support for the position that a rate [] could be an "[]". In response to Brazil's statements regarding support to Comair at rates [ ][1], Canada had ample opportunity to make this argument to the Panel in its 13 August submission, but voluntarily chose not to do so. Canada thus cannot now present, and the Panel cannot accept, this additional argument without violating Brazil's right to due process. The Panel should therefore reject Canada's comment.

[1] *See* Statement of Brazil for the Second Meeting of the Panel, 31 July 2001, paras. 84-85.

Paragraph 7.392, Footnote 303

Canada's comment on footnote 303 states, in part, that this note "suggests, incorrectly, that Canada failed to provide information when requested to do so by the Panel."

Brazil notes that although Canada's 25 June letter summarily refers to IQ's role, as does page 12 of the attachment to that letter, Canada did not provide the Panel with CQC's "Sommaire de transaction" (Exhibit Cda-106), which provides the details of IQ's involvement, until 31 August 2001, in response to the Panel's 24 August 2001 letter. The Panel should therefore reject Canada's comment.

Paragraph 7.387

Canada's comment on this paragraph states that, "It appears that the last word of the second last sentence, 'excluded', should read 'included'."

Brazil believes the word "excluded," in the sentence to which Canada refers, should be replaced with the word "provided."

Technical Correction

Brazil notes that Canada's exhibits in this proceeding were labelled or referred to as either "Exhibit CDA-XX" or "Exhibit Cda-XX."

ANNEX B

Submissions of Canada

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ANNEX B-1

COMMUNICATION OF 16 MAY 2001 FROM CANADA TO BRAZIL

(16 May 2001)

Brazil's panel request in the above-noted dispute has raised seven claims. In order to know the case that it has to answer and the violations that Brazil is alleging, Canada requests further clarification from Brazil as to certain of these claims. In particular:

1. Canada seeks confirmation from Brazil that, pursuant to the title of this dispute and the 21 February 2001 consultations as described in Brazil's request, Brazil's claims 1, 5 and 7 are intended to refer to certain practices or programs only as they relate to regional aircraft.

2. Canada seeks clarification as to whether Brazil's claims 1, 5 and 7 are in respect of certain practices or programs *per se* or as they have been applied in specific instances. If the latter, Canada asks that Brazil identify the applications of the practices or programs to which its claims refer.

3. Brazil's claims 1, 5 and 7 allege that "export credits" are prohibited export subsidies. Brazil's panel request indicates that "export credits" includes certain types of practices, but its claims do not appear to be limited to these types of "export credits". The same is true of "guarantees" as used in Brazil's claim 7. Canada asks that Brazil specify the types of export credits and guarantees to which these claims refer.

4. Brazil's claim 1 alleges that certain practices "are and continue to be prohibited export subsidies…". Canada seeks clarification as to the distinction Brazil is making between "are" and "continue to be".

5. Brazil's claim 3 refers to export credits to the "regional aircraft industry" through the Canada Account. Canada seeks clarification as to what is meant by "regional aircraft industry" as it is used in this claim.

To enable Canada to prepare its defence even before the filing of the first written submissions, Canada asks that Brazil provide these clarifications no later than Monday, 21 May 2001.

ANNEX B-2

RESPONSE OF CANADA TO COMMUNICATION OF 21 MAY 2001 FROM BRAZIL TO THE PANEL

(28 May 2001)

1. In a letter to the Panel of 21 May 2001, Brazil has asked the Panel immediately to request that Canada provide documents regarding Export Development Corporation, Canada Account and Investissement Quebec support for Canadian regional aircraft transactions since the coming into force of the WTO Agreement in 1995. This letter provides Canada's comments on the Brazilian letter.

General Comments

2. Canada will limit its comments to the appropriateness of Brazil's request. Canada notes that Brazil, in its letter, makes a variety of arguments and allegations that it asserts constitute a *prima facie* case that certain Canadian programmes are inconsistent with Canada's obligations under the SCM Agreement. Canada does not agree either with Brazil's arguments and allegations or that they would constitute a *prima facie* case. However, Canada will not address them in this response. As the Appellate Body has found, and Brazil's letter acknowledges, whether a *prima facie* case has been demonstrated is irrelevant to whether and when a panel might undertake the kind of information gathering exercise proposed by Brazil.

3. Canada wishes to cooperate in every possible way in this dispute, including the provision of information that the Panel considers necessary for its task. Canada nevertheless respectfully suggests that the request by Brazil should be declined as both premature and overbroad.

4. Canada submits that any request is premature at this stage, in the context of this dispute. What information a panel may need to request depends on what is properly at issue in a dispute and whether that information will be available on a timely basis in the normal course of the dispute. Careful reflection is particularly warranted where, as in this case, much of the information is of a commercially sensitive nature. The Brazilian request for a panel is unclear in many respects and also appears to contain allegations regarding Canadian compliance with a prior DSB recommendation. These allegations are outside the jurisdiction of a panel formed to hear a new claim under Article 6 of the DSU. As the Panel is aware, Canada, acting in accordance with the guidance of the Appellate Body in *Thailand – Steel*[1] asked by letter of 16 May 2001 for Brazil to clarify its claims. However, Brazil refused to do so, saying in effect that Canada would have to learn the claims against it from Brazil's first submission.

5. Brazil's letter is also misleading in asserting that Canada has refused to produce evidence in response to Brazilian requests. Brazil's only prior request to Canada for information was much narrower than that which Brazil is now requesting. That request was presented to Canada for the first

[1] Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland, (WT/DS122/AB/R), 12 March 2001, para 97.

time at the consultation meeting, at which Canada answered Brazil's questions to the best of its ability under the circumstances.

6. Brazil's current request also is clearly overbroad. Leaving aside all questions as to their consistency with the DSU, the claims in Brazil's request for the establishment of a panel appear to be a series of accusations about the current practices of the agencies concerned. By contrast, in its letter of 21 May, Brazil asks the Panel to solicit comprehensive information about completed transactions going back more than six years.

Brazil's Request is Premature

7. In Canada's view it is not appropriate for the Panel to seek information at this stage of the proceedings in this case. The reason for a panel to request information is because the panel has determined that it requires that information. What information a panel considers "necessary and appropriate " (to use the language of Article 13.1), will depend on the claims before the panel and the arguments of the parties. In the present case, with the exception of Brazil's letter of 21 May, which refers in detail only to the Air Wisconsin transaction, the parties have not presented their arguments, and indeed, Brazil has not presented clear, proper claims in its request for a panel.

8. In *Canada – Measures Affecting the Export of Civilian Aircraft*[2], the panel declined to seek any information before receiving at least the first written submissions of the parties. The panel stated at paragraph 9.50 of its Report:

> We did not consider it appropriate to seek any information before receiving at least the first written submissions of both parties. We considered that it was only on the basis of these first written submissions that we could properly determine what, if any, additional information might need to be sought. In this regard, we recall that the Appellate Body in *India-Patents* referred to "additional fact-finding" by a panel in a context where pertinent facts are "not before the panel". In our view, the Appellate Body could not have been referring in that case to a situation where information is not before the panel because the panel has not yet received any submissions from the parties. Any contrary view would be absurd, since it would at once defeat the very purpose of the parties making written submissions. [footnotes omitted]

9. The panel added, at paragraph 9.53:

> In the circumstances of the present case, we did not consider it appropriate to exercise our discretionary authority under Article 13.1 to make generalized requests for information. Instead, we only sought detailed information of relevant loans, funds, contributions, assistance etc. identified in the record. Whereas more generalized requests for information (of the sort envisaged in Brazil's submission of 23 October 1998) may be appropriate for bodies such as commissions of enquiry, we do not consider them appropriate for a panel acting under Article 13.1 of the DSU.

10. The reasons of the panel in that dispute are equally persuasive in the present dispute. Brazil, in its panel request and in its letter of 21 May 2001 has referred to only one transaction, that involving Air Wisconsin. Canada will be addressing the Air Wisconsin transaction in its first submission. If, once both parties have filed their submissions, the Panel considers that pertinent facts with respect to Brazil's offer to support Air Wisconsin and Canada's offer in response are not before it, the Panel may then need to exercise its discretion to seek additional information under Article 13.1 of the DSU.

[2] Canada – Measures Affecting the Export of Civilian Aircraft, (WT/DS70/R) 14 April 1999.

11. In this regard, Canada notes that at paragraph 12 of its 21 May letter, Brazil acknowledges that in respect of Air Wisconsin transaction, Canada has simply sought to match support offered (or in Brazil's words, "allegedly offered") by Brazil to help its aircraft manufacturer Embraer secure the sale. Brazil alleges that such support by Canada is a prohibited export subsidy. However, in a separate proceeding[3], Brazil has asserted that the export financing support it offers on Embraer regional aircraft has been WTO consistent since last year. To address this inconsistency, Canada asks that if, at any time, the Panel does decide to seek information under Article 13.1 of the DSU, it seek from Brazil information of the sort identified in paragraph 29 of Brazil's 21 May letter, with respect to all financing support provided, offered or proposed by Brazil and/or Embraer since 4 August 2000[4] to potential or actual purchasers of Embraer regional aircraft.

12. Fundamentally, Canada considers that few of Brazil's seven claims are properly before this panel. At least two of Brazil's claims, those numbered 2 and 3 in its request for the establishment of a panel, and perhaps Brazil's claims 1 and 4 as well, appear to allege Canadian non-compliance with the recommendations and rulings of the DSB in the *Canada – Aircraft* dispute. The appropriate procedures for addressing such alleged non-compliance are set out in Articles 21 and 22 of the DSU and involve, wherever possible, recourse to the original panel.

13. In addition, Brazil's claims 1, 5 and 7 are inadequate to meet the requirements of Article 6.2 of the DSU. Canada 's letter of 16 May 2001 asked Brazil to clarify these claims and its claim 3 as well. However, Brazil has refused to do so, as it informed the Panel, and Canada, in its response of 21 May.

14. Accordingly, Canada will be seeking preliminary findings from the Panel with respect to Brazil's claims. At the May 23 organizational meeting, Canada asked the Panel to set aside time in the schedule for this purpose. As it cannot be necessary or appropriate for a panel to seek information in respect of claims that are not properly before it, Canada respectfully suggests that the Panel will be in a position to assess whether it needs specific information only once it has made preliminary findings on the adequacy and appropriateness of Brazil's claims and has received the parties' first submissions.

Brazil's Allegation that Canada Has Refused to Produce Evidence Is Irrelevant or Incorrect

15. Brazil bases its 21 May request to the Panel in part on the allegation that Canada has refused to provide information in a past panel proceeding and in bilateral consultations in this dispute. Neither contention is a fair basis for acceding to Brazil's request. Canada did refuse to provide certain information requested by the panel in Brazil's previous regional aircraft dispute with Canada. Canada did so for two reasons it considered legitimate according to its understanding of Article 13 of the DSU at that time: the inadequacy of the procedures for protecting business confidential information and Brazil's failure to make a *prima facie* case. The Appellate Body subsequently disagreed with Canada's views. Canada's response to a request by a panel in another dispute is irrelevant to the issue of whether this Panel should request certain information in this dispute.

16. Brazil also alleges that Canada refused to "produce" any information in the course of consultations. This is simply untrue. Even if the adequacy of consultations were relevant to this issue, which is doubtful, Brazil has neglected in its 21 May letter to acknowledge that it did not provide Canada with any of the questions it has attached as exhibit Bra-1 in advance of the

[3] Brazil – Export Financing Programme for Aircraft, Second Recourse by Canada to Article 21.5 of the DSU.

[4] This date was the date of adoption of the Appellate Body Report and Panel Report as modified by the Appellate Body Report in the first Article 21.5 proceeding regarding regional aircraft export subsidies by Brazil under its PROEX programme.

consultations. Rather, it withheld them until the parties were in the room at the consultations. (By contrast, members of the Brazilian media received the questions prior to the consultations). Canada answered Brazil's questions to the best of its ability under the circumstances. Having chosen not to accord Canada an opportunity to prepare, if Brazil now considers Canada's answers to have been insufficient, it has only itself to blame.

17. Moreover, if Brazil regarded Canada's answers as inadequate, or if it felt that it required any other specific information, it could have made a written request to Canada under Article 25.8 of the SCM Agreement. In fact, the Appellate Body identified this course of action in its Report in *the Canada-Aircraft* case in August 1999, with respect to certain of the EDC's financing measures.[5] However, Brazil did not do so.

Brazil's Request is Overbroad

18. Contrary to what is implied in Brazil's 21 May letter, the questions it put to Canada in the consultations in this dispute differ greatly from the information it is now asking the Panel to seek. As Brazil's exhibit Bra-1 shows, at the consultations, Brazil did not request any documents from Canada and most of the questions related either to the Air Wisconsin transaction or more generally to the use of the Canada Account since 20 August 1999.

19. Moreover, in last year's Article 21.5 proceeding in the *Canada – Aircraft* dispute, Brazil agreed that there was no issue concerning past Canada Account subsidies, both because prior to the 18 November 1999 deadline for compliance Canada had completed the transactions found to be subsidies and had granted no new Canada Account financing in the regional aircraft sector since that date.[6]

20. Even if that were not so, the claims made in Brazil's request for the establishment of a panel in this dispute are worded in the present tense and appear to relate to the current practices of the agencies concerned. By contrast, Brazil's 21 May letter asks the Panel to seek "documents concerning EDC, Canada Account and IQ support for Canadian regional aircraft transactions from 1 January 1995 onward, including but not limited to the Air Wisconsin deal". Thus, Brazil is now asking the panel to cast its net far more broadly than Brazil itself did in the consultations and more broadly than its claims in its request for a panel would seem to warrant.

Conclusion

21. The assertions made in Brazil's 21 May letter are neither accurate nor a basis for acceding to Brazil's request for immediate, sweeping information gathering beyond the scope of Brazil's complaint and certainly beyond the scope of its consultations with Canada. Canada respectfully requests that the Panel defer information requests until it has clarified what information it needs from either or both parties, having regard to which claims are legitimately before the Panel and what information has been provided in the submissions of the parties.

22. If the Panel has any questions regarding these comments, Canada would be pleased to respond.

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[5] (WT/DS70/AB/R), 2 August 1999, Para. 206.

[6] 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. 5.57.

ANNEX B-3

PRELIMINARY SUBMISSION OF CANADA REGARDING THE PANEL'S JURISDICTION

(18 June 2001)

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I. INTRODUCTION

1. In its request for the establishment of a panel in this dispute[1], Brazil has failed to comply with certain mandatory requirements of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). It has raised certain claims which fall outside the jurisdiction of this panel. These claims should be rejected.

2. The specific violations of the DSU in Brazil's panel request are as follows:

- Claims 1, 2 and 3 raise issues of compliance or implementation related to another dispute. These claims are inconsistent with Article 21.5 of the DSU. This panel does not have the jurisdiction to examine compliance issues that have arisen in other disputes; and

- Claims 1, 2, 5 and 7 are inconsistent with the requirements of Article 6.2 of the DSU, which require a complaining party to identify the specific matters at issue and to provide a brief summary of the legal basis of the complaint, sufficient to present the problem clearly. Brazil has not met the minimum standards of this provision.

3. A WTO panel has both the right and the obligation to determine whether the claims raised by a party fall within its jurisdiction. It is equally clear that Canada, as a defending party, is entitled to its full measure of due process in this dispute. As this submission explains, Brazil's violations of the DSU undermine Canada's due process rights in these proceedings. It is therefore incumbent on the panel to declare that certain claims do not fall within its jurisdiction.

4. Nevertheless, because of the sequence established by paragraph 13 of the Working Procedures, Canada will also show in its first written submission that Brazil's claims fail on the merits.

II. THE PANEL HAS THE RIGHT AND THE OBLIGATION TO DECIDE WHETHER A PARTY'S CLAIMS FALL WITHIN ITS JURISDICTION

5. It is well established in WTO dispute settlement that a Panel has both the right and the duty to determine whether the claims raised by a party comply with the DSU. As noted by the Appellate Body in *EC – Bananas*:

> We recognize that a panel request will usually be approved automatically at the DSB meeting following the meeting at which the request first appears on the DSB's agenda. As a panel request is normally not subject to detailed scrutiny by the DSB, *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*. [2] [emphasis added]

[1] *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Request for the Establishment of a Panel by Brazil, WT/DS222/2, 1 March 2001.

[2] *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, Report of the Appellate Body, WT/DS27/AB/R, adopted 25 September 1997, para. 142 [hereinafter "*EC – Bananas*, Appellate Body Report"].

6. This statement was re-affirmed by the Appellate Body in *Korea – Dairy Safeguard* [3] and in *Thailand – Anti-Dumping Duties on Steel*. [4]

7. Indeed, the Appellate Body has "stressed, on more than one occasion, the fundamental importance of a panel's terms of reference."[5] Thus, as a preliminary matter, it is imperative that this Panel determine whether certain of the claims advanced by Brazil in this case fall within its jurisdiction. As the Appellate Body stated in *India – Patent Protection for Pharmaceutical and Agricultural Products*:

> Nothing in the DSU gives a panel the authority either to disregard or to modify other explicit provisions of the DSU. The jurisdiction of a panel is established by that panel's terms of reference, which are governed by Article 7 of the DSU. *A panel may consider only those claims that it has the authority to consider under its terms of reference. A panel cannot assume jurisdiction that it does not have*.[6] [emphasis added]

8. As will be argued by Canada below, the Panel in this case does not have the authority, under its terms of reference, to consider a number of the claims made by Brazil. This panel cannot assume jurisdiction that it does not have.

III. CERTAIN OF BRAZIL'S CLAIMS ARE INCONSISTENT WITH ARTICLE 21.5 OF THE DSU

A. APPLICABLE LAW

9. The DSU provides that disputes over compliance are to be resolved through the expedited proceedings provided for in Article 21.5, rather than through new panel proceedings.

10. Article 21.5 provides as follows:

> 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. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report.

11. Article 21.5 uses mandatory, not hortatory, language. Where there is disagreement over implementation, such a dispute "shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel."

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[3] *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, Report of the Appellate Body, WT/DS98/AB/R, adopted 14 December 1999, para. 122 [hereinafter "*Korea – Dairy Safeguard*, Appellate Body Report"].

[4] *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Appellate Body, WT/DS122/AB/R, adopted 5 April 2001, para. 86 [hereinafter "*Thailand – Steel*, Appellate Body Report"].

[5] *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Appellate Body, WT/DS50/AB1R, adopted 16 January 1998, para. 87 [hereinafter "*India – Patent Protection*, Appellate Body Report"].

[6] *Id*., para. 92.

12. Thus the DSU mandates recourse to Article 21.5 expedited procedures to resolve implementation disputes, unless it is "impossible" to use these procedures.

13. This interpretation is consistent with the practice to date of WTO Members. In all cases to date in which there has been a dispute over the existence or WTO -consistency of measures taken to comply with DSB recommendations or rulings, resort has been made to Article 21.5.[7] To allow a Member to ignore the specific requirements of Article 21.5 and instead to resort to *de novo* panel proceedings to determine issues of compliance would be contrary to Article 21.5.

14. More fundamentally, any Panel established through the regular dispute settlement procedures of Article 6 of the DSU would not have the jurisdiction to make findings on issues of compliance arising from other cases. Such other cases have different terms of reference, and different panel members. Where a complaining party asserts that a defending party has failed to comply with DSB rulings in a particular case, the proper avenue to pursue such claims is to reconvene the original panel.

B. THE MATTERS AT ISSUE

15. In its 1 March 2001 request for a panel, Brazil has made three claims that would require this panel to adjudicate issues of compliance with the earlier DSB rulings in a different case. It has done so explicitly in Claims 2 and 3, and implicitly in Claim 1. These claims must be pursued through an Article 21.5 compliance panel proceeding rather than through this proceeding.

[7] *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products – Recourse to Article 21.5 of the DSU*, Request for Consultations, WT/DS50/11, 20 January 1999; *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by Ecuador*, Report of the Panel, WT/DS27/RW/ECU, adopted 6 May 1999; *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 by the European Communities*, Report of the Panel, WT/DS27/RW/EEC; *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 by Canada*, Report of the Panel, WT/DS18/RW, adopted 20 March 2000; *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States*, Report of the Panel, WT/DS126/RW, adopted 11 February 2000; *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, report of the panel and the Appellate Body adopted 4 August 2000; *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW; report of the panel and the Appellate Body adopted 4 August 2000; *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse by the United States to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS132/6, 13 October 2000; *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse by Malaysia to Article 21.5 of the DSU*, Report of the Panel, WT/DS58/RW, 15 June 2001; *United States – Anti-Dumping Duties on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea – Recourse to Article 21.5 of the DSU by Korea*, Report of the Panel (Suspension of Panel Proceedings), WT/DS99/RW, 7 November 2000; *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse by the European Communities to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS108/16, 8 December 2000; *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS46/26, 22 January 2001; *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse by the United States to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS103/16, 19 February 2001; *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse by New Zealand to Article 21.5 of the DSU*, Request for the Establishment of a Panel, WT/DS113/16, 19 February 2001.

1. Explicit compliance claims

16. Claim 2 states that:

> *Canada has not implemented the report of the Article 21.5 panel*, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

17. Claim 2 fails to specify which "report of the Article 21.5 panel" is the subject of the current Brazilian complaint. Canada presumes that it is the report of the Article 21.5 panel in *Canada – Measures Affecting the Export of Civilian Aircraft*.[8] In any event, a complaint that Canada "has not implemented" the Article 21.5 panel report is clearly an issue of compliance or implementation related to an earlier dispute, which is outside the jurisdiction of the present panel.

18. Claim 3 provides:

> Canada, in defiance of the rulings and recommendations of the Dispute Settlement Body, continues to grant or offers to grant export credits to the regional aircraft industry through the Canada Account, that are prohibited subsidies within the meaning of Articles 1 and 3 of the Agreement.

19 Once again, Brazil has referred to "the rulings and recommendations of the Dispute Settlement Body", without any reference as to which such rulings or recommendations are the subject of the current complaint. Again, Canada surmises that Brazil is referring to the rulings and recommendations of the DSB in *Canada – Measures Affecting the Export of Civilian Aircraft*. The reference to the alleged granting of, or offers to grant, prohibited subsidies "in defiance of" the DSB rulings clearly indicates that this claim raises issues of compliance with earlier rulings. Such claims are outside the jurisdiction of the current panel.

2. Implicit compliance claim

20. Claim 1 states that:

> Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and *continue to be* prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

21. In this claim, Brazil asserts in part that certain export credits "continue to be" prohibited export subsidies. All measures of a Member are presumed to be WTO-consistent absent a specific DSB ruling to the contrary. Therefore, the reference by Brazil to export credits that "continue to be" prohibited export subsidies must refer back to earlier DSB rulings that certain "export credits" granted by Canada are not WTO-consistent. This would appear to be a claim that Canada has not complied with the DSB rulings in *Canada Measures Affecting the Export of Civilian Aircraft*.[9] This panel does not have the jurisdiction to determine issues of compliance related to other cases.

3. Compliance disputes cannot be resolved through new panel proceedings

22. Thus, in its request for the establishment of a panel, Brazil has raised compliance issues, both explicitly and implicitly. As noted above, DSU Article 21.5 provides that implementation disputes

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[8] *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, adopted 4 August 2000.

[9] In its letter of 16 May 2001, Canada asked Brazil to clarify this claim. However, as noted below, Brazil refused to do so.

are to be resolved "through recourse to these dispute settlement procedures, including *wherever possible resort to the original panel*." It was clearly "possible" for Brazil to seek to resort to the original panel, yet Brazil made no attempt to do so.

23. If Brazil believes that Canada had not complied with the DSB recommendations in the Article 21.5 proceeding in *Canada – Measures Affecting the Export of Civilian Aircraft*, it could also have requested DSB authorization to take appropriate countermeasures pursuant to Article 4.10 of the SCM Agreement and Article 22.6 of the DSU. Brazil did not seek to do so.

24. Brazil instead is seeking to have this panel rule on issues of implementation related to a different dispute. This would be unprecedented in the history of the WTO and contrary to the requirements of Article 21.5.

25. This Panel does not have the jurisdiction to adjudicate compliance issues that have arisen in other cases. The issues before the Panel in the present case may be similar to those examined by the Panel in *Canada – Measures Affecting the Export of Civilian Aircraft*. However, they are still different panels, established in different disputes, with different terms of reference and different members of the panel. The present Panel has no more jurisdiction to determine compliance issues arising from *Canada – Measures Affecting the Export of Civilian Aircraft* than it does to determine compliance issues arising from *Bananas*, *FSC*, or any other different WTO dispute.

IV. BRAZIL'S CLAIMS 1, 2, 5 and 7 ARE INCONSISTENT WITH ARTICLE 6.2 OF THE DSU

A. APPLICABLE LAW

1. DSU Article 6.2: text and objective

26. Requests for the establishment of a Panel must comply with the requirements of DSU Article 6.2. Article 6.2 provides in part as follows:

> The request for the establishment of a panel ... shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

27. The Appellate Body has stressed the need to adhere to the requirements of DSU Article 6.2:

> It is important that a panel request be sufficiently precise for two reasons: first, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and, second, it informs the defending party and the third parties of the legal basis of the complaint.[10]

2. Due process objective of Article 6.2

28. It is clear that "a defending party is always entitled to its full measure of due process in the course of WTO dispute settlement."[11]

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[10] *EC – Bananas*, Appellate Body Report, para. 142; *Korea – Dairy Safeguard*, Appellate Body Report, para. 122; *Thailand – Steel*, Appellate Body Report, para. 84.

[11] *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Panel, WT/DS122/R, adopted with the Appellate Body Report 5 April 2001, para. 7.24 [hereinafter "*Thailand – Steel*, Panel Report"] See also the Report of the Panel in *Turkey –*

29. Moreover, the fundamental fairness of the proceedings may be undermined where the complaining party has failed to comply with the requirements of Article 6.2, particularly the obligation to "provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly." In *Thailand – Steel*, the Appellate Body stated that:

> Article 6.2 of the DSU calls for sufficiently clarity with respect to the legal basis of the complaint, that is, with respect to the "claims" that are being asserted by the complaining party. *A defending party is entitled to know what case it has to answer, and what violations have been alleged so that it can begin preparing its defence.* Likewise, those Members of the WTO who intend to participate as third parties in panel proceedings must be informed of the legal basis of the complaint. *This requirement of due process is fundamental to ensuring a fair and orderly conduct of dispute settlement proceedings*.[12] [emphasis added]

3. Requirements of Article 6.2

30. In *Korea – Dairy Safeguard*, the Appellate Body discussed the requirements imposed by Article 6.2:

> When parsed into its constituent parts, Article 6.2 may be seen to impose the following requirements. The request must: (i) be in writing; (ii) indicate whether consultations were held; (iii) identify the specific measures at issue; and (iv) provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In its fourth requirement, Article 6.2 demands only a summary – and it may be a brief one – of the legal basis of the complaint; but the summary must, in any event, be one that is "sufficient to present the problem clearly". It is not enough, in other words, that "the legal basis of the complaint" is summarily identified; the identification must "present the problem clearly".[13]

31. Whether a request for the establishment of a panel meets the requirements of Article 6.2 must be decided on a case-by-case basis.[14] As the *Korea – Dairy Safeguard* Appellate Body report stated:

> Identification of the treaty provisions claimed to have been violated by the respondent is always necessary both for purposes of defining the terms of reference of a panel and for informing the respondent and the third parties of the claims made by the complainant; such identification is a minimum prerequisite if the legal basis of the

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Restrictions on Imports of Textile and Clothing Products, WT/DS34/R, adopted with the Appellate Body report 19 November 1999, para. 9.3.

[12] *Thailand – Steel*, Appellate Body Report, para. 88. Similarly, in *Brazil – Measures Affecting Desiccated Coconut*, the Appellate Body noted that:

> A panel's terms of reference are important for two reasons. First, *terms of reference fulfil an important due process objective* - they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the complainant's case. Second, they establish the jurisdiction of the panel by defining the precise claims at issue in the dispute. [emphasis added]

Appellate Body Report, WT/DS22/AB/R, adopted 20 March 1997, p. 22 [hereinafter "*Brazil – Coconut*, Appellate Body Report"].

[13] *Korea – Dairy Safeguard*, Appellate Body Report, para. 120.

[14] *Id.*, para. 127; *Thailand – Steel*, Appellate Body Report, para. 87.

> complaint is to be presented at all. But it may not always be enough. There may be situations where the simple listing of the articles of the agreement or agreements involved may, in the light of attendant circumstances, suffice to meet the standard of *clarity* in the statement of the legal basis of the complaint. However, there may also be situations in which the circumstances are such that the mere listing of treaty articles would not satisfy the standard of Article 6.2. This may be the case, for instance, where the articles listed establish not one single, distinct obligation, but rather multiple obligations. In such a situation, the listing of articles of an agreement, in and of itself, may fall short of the standard of Article 6.2.[15] [emphasis in original]

4. Deficiency in panel request cannot be "cured" by submission

32. It is well established that the requirements of Article 6.2 must be met in the request for the panel, and that any deficiencies in the panel request cannot be "cured" by the submissions of the complainant. The Appellate Body in *EC – Bananas* held that:

> We do not agree with the Panel that "even if there was some uncertainty whether the panel request had met the requirements of Article 6.2, the first written submissions of the Complainants 'cured' that uncertainty because their submissions were sufficiently detailed to present all the factual and legal issues clearly". Article 6.2 of the DSU requires that the *claims*, but not the *arguments*, must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending party and any third parties to know the legal basis of the complaint. If a *claim* is not specified in the request for the establishment of a panel, then a faulty request cannot be subsequently "cured" by a complaining party's argumentation in its first written submission to the panel or in any other submission or statement made later in the panel proceeding.[16] [emphasis in original]

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[15] *Korea – Dairy Safeguard*, Appellate Body Report, para. 124; *Thailand – Steel*, Appellate Body Report, para. 87 . See also the Report of the Panel in *Mexico – Anti-Dumping Investigation of High-Fructose Corn Syrup (HFCS) from the United States*, WT/DS132/R, adopted 24 February 2000; para. 7.13.

The Panel in the *Bed Linen* case rejected certain claims made by India under Article 6 of the Anti-Dumping Agreement because India had failed to set forth such claims in its request for the establishment of the panel. The panel recalled that in the *Korea – Dairy Safeguard* dispute, the Appellate Body had found that there might be situations where a "mere listing" of treaty Articles would not satisfy the standards of Article 6.2. It then went on to state that:

> … the treaty Articles alleged to be violated *are not even listed* in the request for establishment – "Article 6" of the AD Agreement does [not] appear on the face of the document at all. In this circumstance, we consider that the legal basis of a complaint with respect to that Article has not been presented at all. … In our view, a failure to state a claim in even the most minimal sense, by listing the treaty Articles alleged to be violated, cannot be cured by reference to subsequent submissions. … Thus, the fact that India may have fully elucidated its position with respect to alleged violations of Article 6 of the AD Agreement in its first written submission to the Panel avails it nothing as a legal matter. Failure to even mention in the request for establishment the treaty Article alleged to have been violated in our view constitutes failure to state a claim at all. [emphasis in original]

European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India, Report of the Panel, WT/DS141/R, adopted with the Appellate Body report on 12 March 2001, paras. 6.13 and 6.15 [hereinafter "*EC – Bed Linen*, Panel Report"].

[16] *EC – Bananas*, Appellate Body Report, para. 143. See also *European Communities – Customs Classification of Certain Computer Equipment*, Report of the Appellate Body, WT/DS62/AB/R,

33. In a subsequent case, the Appellate Body reinforced this point by stating that "a claim *must* be included in the request for establishment of a panel in order to come within a panel's terms of reference in a given case."[17] [emphasis in original]

5. Efforts of the Defending party to seek clarifications

34. Previous cases have noted that the defending party may seek clarifications from the complaining party about the claims that have been made. As the Appellate Body stated in *Thailand – Anti-Dumping Duties on Steel*:

> In view of the importance of the request for the establishment of a panel, we encourage complaining parties to be precise in identifying the legal basis of the complaint. We also note that nothing in the DSU prevents a defending party from requesting further clarification on the claims raised in a panel request from the complaining party, even before the filing of the first written submission. In this regard, we point to Article 3.10 of the DSU which enjoins Members of the WTO, if a dispute arises, to engage in dispute settlement procedures "in good faith in an effort to resolve the dispute". As we have previously stated, the "procedural rules of WTO dispute settlement are designed to promote, not the development of litigation techniques, but simply the fair, prompt and effective resolution of trade disputes". [18].

6. Prejudice to the Defending Party

35. In determining whether Article 6.2 has been violated, Panels and the Appellate Body have taken into account whether there has been prejudice to the rights of defence of the Defending party

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WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, para. 72, footnote 49; and *EC – Bed Linen*, Panel Report, para. 6.15. In addition, the Panel in the *Argentina – Footwear* dispute noted that: "Clearly, due process and adequate notice would not be served if a complaining party were free to add new measures or new claims to its original complaint as reflected in its panel request at a later stage of a panel proceeding." (*Argentina – Safeguard Measures on Imports of Footwear*, Report of the Panel, WT/DS121/R, panel and Appellate Body report adopted on 12 January 2000, para. 8.45.)

[17] *India – Patent Protection*, Appellate Body Report, para. 89. See also *Brazil – Coconut*, Appellate Body Report, p. 22.

[18] *Thailand – Steel*, Appellate Body Report, para. 97.

> Similarly, the Panel in *United States – Lamb* stated that:
>
> ... we consider it appropriate to recall the Appellate Body's statements in *United States – Tax Treatment for Foreign Sales Corporations ("US - FSC")* that:
>
> > "responding Members [should] seasonably and promptly bring claimed procedural deficiencies to the attention of the complaining Member, and to the DSB or the Panel, so that corrections, if needed, can be made to resolve disputes."
>
> We note that the Appellate Body made the preceding statements in relation to the "statement of available evidence" as required by SCM Agreement Article 4.2 in the context of a request for *consultation*s, not a request for a *panel*. But we nevertheless find the above statement of the Appellate Body to be relevant to our examination of "attendant circumstances" in this case in connection with the procedural issue [DSU Article 6.2] before us. [emphasis in original] [footnote omitted]
>
> *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, Report of the Panel, WT/DS/177/R, WT/DS178/R, adopted with the Appellate Body report 16 May 2001, paras. 5.44-5.45.

during the course of the panel proceedings. For example, the Panel in *Thailand – Steel*, in dismissing Poland's claims under Article 6 of the Anti-Dumping Agreement, stated:

> ... we find that Thailand has demonstrated, with respect to Poland's claims under this Article, that its ability to defend itself was prejudiced in the course of the Panel proceedings. The prejudice to Thailand's ability to defend itself was a function of the fact that the precise nature and scope of the claims under Article 6 remained unclear and confusing to Thailand – and to us – even following Poland's first written submission.[19]

36. The *Bed Linen* panel commented on the issue of prejudice in the case where a complaining party has not made a particular claim in its panel request:

> In the absence of any reference in the request for establishment to the treaty Article alleged to have been violated, the question of possible prejudice as a result of failure to state a claim with sufficient clarity simply does not arise. … Whether inadvertent or not, as a result of the omission of Article 6 from the request for establishment the defending Member, the European Communities, and third countries had no notice that India intended to pursue claims under Article 6 of the AD Agreement in this case, and were entitled to rely on the conclusion that it would not do so. Consequently, India would be estopped in any event from raising such claims.[20]

B. THE MATTERS AT ISSUE

37. In accordance with the fundamental principles of procedural fairness, as enunciated by the Appellate Body in the *Thailand – Steel* case, Canada is entitled to know what case it has to answer, and what violations have been alleged, so that it can prepare its defence. As the Appellate Body has made clear, this requirement of due process is "fundamental to ensuring a fair and orderly conduct of dispute settlement proceedings."

38. Even if Brazil were not under an obligation to bring its Claims 1 and 2 in an Article 21.5 proceeding, they are inconsistent with DSU Article 6.2 because they do not identify the specific measures at issue and because they do not present the problem clearly. Either failure on its own is a violation of Article 6.2. Brazil's Claims 5 and 7 are similarly inconsistent with Article 6.2. Brazil's failure to comply with the requirements of Article 6.2 undermines the fundamental fairness of these proceedings.

39. The specific inconsistencies of each Claim with the requirements of Article 6.2 are set out below.

1. Claim 1

40. As noted above, in Claim 1, Brazil states that:

> Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

41. The reference to "export credits" is extremely broad. Any practice that allows payment to be deferred for an exported good or service could conceivably qualify as an "export credit." Moreover,

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[19] *Thailand – Steel*, *Panel* Report, para. 7.29. This finding was not appealed by Poland.
[20] *EC – Bed Linen*, Panel Report, para. 6.16.

the term "export credits" is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry. The scope of "export credits", without any further clarification, is infinite. Brazil has failed to specify either the meaning or the scope of its claim.

42. The term "Canada Account" is not limited in any way in Brazil's claim. It is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry. It appears from the terms of the claim that Brazil is challenging the whole of Canada Account. Canada Account transactions number in the hundreds and vary from tied-aid transactions to insurance products.[21]

43. Thus, Canada submits that by using the terms "export credits" and "Canada Account", Brazil has neither adequately identified the specific measures at issue, nor presented the problem clearly, contrary to Article 6.2 of the DSU.

44. Accordingly, Canada does not know the violations Brazil is alleging and the case it has to answer.

2. Claim 2

45. As stated earlier, Claim 2 provides that:

> Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

46. The Appellate Body report in *Korea – Dairy Safeguard* left no doubt that "[i]dentification of the treaty provisions claimed to have been violated by the respondent is *always necessary* both for purposes of defining the terms of reference of a panel and for informing the respondent and the third parties of the claims made by the complainant; such identification is *a minimum prerequisite* if the legal basis of the complaint is to be presented at all."[22] [emphasis added].

47. However, in Claim 2, Brazil has <u>failed to identify any treaty provision that Canada is alleged to have violated</u>. It makes no reference to any provision of the WTO Agreements. It thus fails to meet the "minimum prerequisites" of Article 6.2. As noted by the *Bed Linen* panel, "[f]ailure to even mention in the request for establishment the treaty Article alleged to have been violated … constitutes failure to state a claim at all." [23]

48. In addition, the arguments under Claim 1 with respect to the "Canada Account" apply equally to Claim 2, and are incorporated by reference here.

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[21] In considering a term as broad as "Canada Account", it is useful to recall the observations of the *Japan – Film* panel when faced with a similar request:

> In considering whether these. … measures were adequately identified in the panel request, we note that in contrast to the Premiums Law, which has a relatively narrow focus (i.e., premiums), the Antimonopoly Law has a very broad scope and deals with a broad range of issues. As such, we would have some hesitation in saying that a reference to the Antimonopoly Law alone would be sufficient to bring all measures taken by Japan under that Law within the scope of the panel request.

However, it was not necessary for the *Japan – Film* panel to decide this issue. (*Japan – Measures Affecting Consumer Photographic Film and Paper*, Report of the Panel, WT/DS44/R; adopted 22 April 1998, para. 10.16.)

[22] *Korea – Dairy Safeguard*, Appellate Body Report, para. 124.
[23] *EC – Bed Linen*, Panel Report, para. 6.15.

3. Claim 5

49. Brazil's fifth Claim states:

> Export credits, including financing, loan guarantees, or interest rate support by or through the EDC are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

50. The arguments under Claim 1 with respect to "export credits" apply equally to Claim 5, and are incorporated by reference here.

51. In addition, Brazil's reference to "the EDC" is similarly so broad as to defy definition. The term "EDC" in this Claim is limited neither to the Air Wisconsin transaction nor the regional aircraft industry. The claim appears to be an ill-defined attack on the whole of EDC, a claim that could potentially cover hundreds of clients and many thousands of transactions since 1995.

52. The deficiency of Brazil's claim is illustrated by paragraphs 46 and 65 of Brazil's First Submission. Those paragraphs indicate that Brazil is seeking in this proceeding to challenge not only the sort of EDC "financial contributions" at issue in *Canada – Aircraft* (*i.e.* those covered by sub-paragraph 1.1(a)(1)(i) of the SCM Agreement), but an unlimited range of "financial services" under sub-paragraph 1.1(a)(1)(iii). In its claim, Brazil neither specified which services it is challenging, nor even identified the specific provisions of Article 1 on which it is relying, contrary to the requirements of Article 6.2 as interpreted by the Appellate Body in *Korea – Dairy Safeguard*.

53. Thus, Canada submits that by using the terms "export credits" and "EDC", Brazil has neither adequately identified the specific measures at issue, nor presented the problem clearly, contrary to Article 6.2 of the DSU.

4. Claim 7

54. The seventh Brazilian Claim is that:

> Export credits and guarantees provided by *Investissement Québec*, including loan guarantees, equity guarantees, residual value guarantees, and "first loss deficiency guarantees" are prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

55. The arguments under Claim 1 with respect to "export credits" apply equally to Claim 7, and are incorporated by reference here.

56. In addition, the reference to "Investissement Québec" in Claim 7 is limited neither to the Air Wisconsin transaction nor to the regional aircraft industry.

57. Thus, Canada submits that by using the terms "export credits" and "Investissement Québec", Brazil has neither adequately identified the specific measures at issue, nor presented the problem clearly, contrary to Article 6.2 of the DSU.

C. BRAZIL REJECTED CANADA'S EFFORTS TO SEEK CLARIFICATION

58. Canada made good-faith efforts to seek clarification with respect to Brazil's panel request. On 16 May 2001, Canada wrote to the Chair of the Panel, seeking the following specific clarifications. The letter stated in part:

> In order to know the case that it has to answer and the violations that Brazil is alleging, Canada requests further clarification from Brazil as to certain of these claims. In particular:
>
> 1. Canada seeks confirmation from Brazil that, pursuant to the title of this dispute and the 21 February 2001 consultations as described in Brazil's request, Brazil's claims 1, 5 and 7 are intended to refer to certain practices or programmes only as they relate to regional aircraft.
>
> 2. Canada seeks clarification as to whether Brazil's claims 1, 5 and 7 are in respect of certain practices or programmes *per se* or as they have been applied in specific instances. If the latter, Canada asks that Brazil identify the applications of the practices or programmes to which its claims refer.
>
> 3. Brazil's claims 1, 5 and 7 allege that "export credits" are prohibited export subsidies. Brazil's panel request indicates that "export credits" includes certain types of practices, but its claims do not appear to be limited to these types of "export credits". The same is true of "guarantees" as used in Brazil's claim 7. Canada asks that Brazil specify the types of export credits and guarantees to which these claims refer.
>
> 4. Brazil's claim 1 alleges that certain practices "are and continue to be prohibited export subsidies…". Canada seeks clarification as to the distinction Brazil is making between "are" and "continue to be".
>
> 5. Brazil's claim 3 refers to export credits to the "regional aircraft industry" through the Canada Account. Canada seeks clarification as to what is meant by "regional aircraft industry" as it is used in this claim.
>
> To enable Canada to prepare its defence even before the filing of the first written submissions, Canada asks that Brazil provide these clarifications no later than Monday, 21 May 2001.

59. Brazil cursorily refused to provide the clarifications requested. In a letter to the Chair of the Panel dated 21 May, Brazil stated that:

> In a letter to the Panel dated May 16, 2001, Canada requested that Brazil provide "confirmation" and "clarification" on a number of points concerning Brazil's challenge to several Canadian subsidies. In accordance with normal practice in the WTO, Brazil intends to present its position to the Panel, to Canada, and to the Third Parties, in its first written submission to the Panel at the time established by the Panel in its Working Procedures.

Thus Brazil refused to clarify its claims, despite Canada's requests.

D. NO "CURE"

60. The requirements of Article 6.2 must be met in the request for the panel. As the Appellate Body made clear in *EC – Bananas*, the deficiencies in the panel request with respect to Claims 1, 2, 3, 5, 7 cannot be "cured" by Brazil's subsequent submissions.

E. PREJUDICE TO CANADA'S DEFENCE

61. As was the case for Thailand in the *Anti-Dumping Duties on Steel* dispute, the prejudice to Canada's ability to defend itself is a function of the fact that the precise nature and scope of the claims by Brazil remain unclear and confusing.[24] Brazil's violations of the mandatory requirements of Article 6.2 of the DSU prejudice Canada's ability to prepare and present a full defence in this proceeding.

V. REQUEST FOR PRELIMINARY RULINGS

62. Canada respectfully requests that the Panel make the following preliminary findings with respect to its jurisdiction:

> 1. Claims 2 and 3 raise issues of compliance related to another dispute. Brazil was required to bring these claims under DSU Article 21.5. Accordingly, Claims 2 and 3 are outside the jurisdiction of the panel;
>
> 2. The reference in Claim 1 to certain export credits that "continue to be" prohibited subsidies similarly raises compliance issues related to another dispute. This claim is also properly the subject of an Article 21.5 proceeding, and accordingly, is outside the jurisdiction of the panel; and
>
> 3. Claims 1, 2, 5 and 7 are inconsistent with the requirements of DSU Article 6.2, and therefore these Claims are outside the jurisdiction of the panel.

[24] With respect to Claim 2, in which Brazil has failed to identify <u>any</u> treaty provision that Canada is alleged to have violated, Canada recalls the statement of the *Bed Linen* panel that "the question of possible prejudice as a result of failure to state a claim with sufficient clarity simply does not arise." *EC – Bed Linen*, Panel Report, para. 6.16.

ANNEX B-4

FIRST WRITTEN SUBMISSION OF CANADA

(18 June 2001)

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I. INTRODUCTION

1. This submission provides Canada's initial response to Brazil's allegations that Canada is providing export subsidies inconsistent with the Agreement on Subsidies and Countervailing Measures ("SCM Agreement"). The task of responding is made difficult, in that the only clear and consistent element of Brazil's complaint at each stage of the process in this dispute is Canada's offer of financing for the sale of regional jet aircraft to Air Wisconsin Airlines Corporation ("Air Wisconsin"). Nevertheless, Canada will respond to all of Brazil's claims insofar as Canada understands them, pending the Panel's disposition of Canada's request, in its Preliminary Submission, for preliminary rulings on certain of Brazil's claims.

2. In its complaints about the Air Wisconsin financing, Brazil neglects to mention that Canada's offer was made to match financing offered last year to Air Wisconsin by Brazil, through its PROEX (Programa de Financiamento as Exportações) interest-rate buy-down programme and BNDES (Banco Nacional de Desenvolvimento Econ⊥mico e Social). In a separate WTO proceeding[1], Brazil has denied that its PROEX programme now constitutes illegal export subsidization. If Brazil is correct, this would mean that Canada's offer to Air Wisconsin must also be consistent with the SCM Agreement, since under the SCM Agreement Brazil has no defences regarding regional aircraft financing that are not also available to Canada. However, even if, as Canada considers, Brazil's offer to Air Wisconsin was an illegal export subsidy, Canada's matching offer is protected under the "safe haven" of the second paragraph of Item (k) of the Illustrative List of export subsidies in Annex I to the SCM Agreement.

3. In its first submission,[2] Brazil appears to claim broadly that any financing by Canada's Export Development Corporation ("EDC") and Investissement Québec is, as such, an export subsidy in violation of the SCM Agreement. In addition, Brazil seems to be challenging either types of financing offered by those agencies or specific transactions in which those agencies were, or are alleged to have been, involved.

4. In any case, Brazil's claims have no foundation. EDC administers two programmes, the Canada Account and the Corporate Account. In a previous dispute settlement case brought by Brazil, both were found to involve discretionary rather than mandatory legislation.[3] Canada Account financing is provided consistent with the interest rates provisions of the *Arrangement on Guidelines for Officially Supported Export Credits*[4] (the "OECD Arrangement" or the "Arrangement") and therefore qualifies for the "safe haven" of Item (k). Since 1998, all Corporate Account financing for regional aircraft has been provided on a commercial basis, and therefore does not confer a "benefit" under Article 1 of the SCM Agreement.[5] Similarly, Investissement Québec does not involve mandatory legislation, its financing does not confer a "benefit" and, even on the basis of Brazil's evidence, it is not contingent upon export performance.

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[1] *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46.

[2] *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222, First Submission of Brazil, 30 May 2001 [hereinafter "Brazil's First Submission"].

[3] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999, paras. 9.123 and 9.129 [hereinafter *Canada – Aircraft I*, Panel Report].

[4] OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998). (Exhibit BRA-42)

[5] From 1 January 1995 through 1997, the Corporate Account was also used for [] official support transactions. These transactions were consistent with the OECD Arrangement. They involved a total of [] propeller-driven aircraft but no regional jets.

5. With no basis for its complaints, Brazil tries to build a case on faulty interpretations of the SCM Agreement, unsustainable legal arguments and selective and sometimes inaccurate quotations from public documents and press reports. These do not demonstrate that Canada has breached its WTO obligations in any way.

6. In this submission, Canada will first show that the programmes or agencies challenged by Brazil are not, "as such", inconsistent with the SCM Agreement. Then it will show that its matching of Brazil's financing offer to Air Wisconsin is permitted under the SCM Agreement. Finally, it will show that there is no basis for Brazil's complaint that the application of Corporate Account or Investissement Québec financing is inconsistent with the SCM Agreement.

II. THE CONTEXT FOR THIS PROCEEDING AND THE FACTS

A. BRAZIL'S PROEX PROGRAMME

7. It is no secret that this proceeding is part of a broader dispute. For several years, Brazil has been engaged in a well-documented campaign of illegal export subsidization to win contracts and gain market-share for Embraer at the expense of its competitors, particularly Bombardier.

8. In 1999 and again last year, the DSB ruled that Brazil provides illegal export subsidies to Embraer under PROEX, Brazil's interest-rate buy-down programme for exports. Under PROEX, Brazil buys down to a lower rate the interest rate commercially available to a potential purchaser of Embraer aircraft. The original version of PROEX ("PROEX I") involves interest rate buy-downs of up to 3.8 percentage points. This means that a potential purchaser that would otherwise have to finance a purchase of Embraer aircraft at, for example, a commercially available interest rate of 8 per cent, would receive financing at a 4.2 per cent interest rate thanks to the PROEX I interest rate buy-down.

9. After a panel had found and the Appellate Body had affirmed that these PROEX subsidies were illegal[6], the DSB ruled that Brazil had until 18 November 1999 to withdraw them. Brazil claimed compliance with the initial ruling of the DSB by revising PROEX to reduce the interest rate buy-down to 2.5 percentage points ("PROEX II"), but Brazil declined to cease granting subsidies with respect to aircraft under contract for delivery after the 18 November 1999 compliance date.

10. In a proceeding under Article 21.5 of the Dispute Settlement Understanding (DSU) Brazil was found not to have complied with the original DSB ruling because (i) after 18 November 1999 it continued to deliver PROEX I subsidized aircraft pursuant to contracts made before that date and the PROEX subsidies were granted on the delivery of the aircraft; and (ii) PROEX II remained a prohibited export subsidy which Brazil continued to grant on Embraer regional jets.[7] When the parties were unable to reach an agreement on compensation, Canada sought and obtained

[6] *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999 [hereinafter "*Brazil – Aircraft*, Panel Report"] and *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999 [hereinafter "*Brazil – Aircraft*, Appellate Body Report"].

[7] *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 [hereinafter "*Brazil - Aircraft*; Article 21.5 Panel Report"] and *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 [hereinafter "*Brazil – Aircraft*, Article 21.5 Appellate Body Report"].

authorization from the DSB to take countermeasures against Brazil in the amount of C$344.2 million per year.[8]

11. In December 2000, Brazil announced that it had again revised PROEX. According to Brazil, this revision, which will be referred to as PROEX III, continued the same programme that has twice been found to be an illegal export subsidy, but with a nominal limit on PROEX interest-rate buy-downs to no more than the Commercial Interest Reference Rate (or "CIRR"). The CIRR is a constructed rate developed at the OECD and published by the OECD as one component of the Arrangement.[9] Brazil's position is that it may offer buy-downs to the CIRR rate, without any of the other terms or conditions required under the Arrangement or by the market. Brazil contends that as a result of this revision, PROEX III interest-rate buy-downs are no longer prohibited export subsidies. Canada disagrees and has challenged the conformity of PROEX III with the WTO rules in a separate proceeding under Article 21.5 of the DSU.

B. AIR WISCONSIN

12. After the Arbitrators had issued their decision in the Article 22.6 proceeding, Embraer and Bombardier became involved in a competition to win a large order from Air Wisconsin for approximately [] regional jets at a purchase price of approximately C$ [] billion. Air Wisconsin is a US regional airline. It operates under a code-share agreement with United Airlines Inc.

13. In late October 2000, Canada learned that Brazil was prepared to finance the sale of Embraer regional jets to Air Wisconsin on terms far more favourable than those that Air Wisconsin would have been able to obtain in the commercial marketplace. Thus, it was evident that Brazil again was offering export subsidies inconsistent with the SCM Agreement on a major sale.

14. Embraer insisted on a commercial confidentiality agreement that precluded Air Wisconsin from disclosing to Canada precise details of the Brazilian offer. However, from the responses of Air Wisconsin officials to a variety of questions posed by Canadian officials, the Government of Canada concluded that the terms of the Brazilian offer included []. Evidence of Brazil's offer is contained in Canada's Confidential Exhibit CDA-1 and Exhibit CDA-2.[10]

15. In the eyes of some observers, Brazil was using a strategy of prolonging negotiations and litigation with a view to continuing its illegal subsidization to gain market share. As a major Brazilian newspaper reported when the Article 22.6 arbitration decision was released:

> "[b]ut the major victory of the MFA [Ministry of Foreign Affairs] 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

[8] *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*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000.

[9] CIRR is determined by taking the average of the 7-year US Treasury rate (in the case of regional aircraft deals, i.e., Category A under Annex III of the Arrangement, in US dollars with repayment terms of over 8 ½ years up to 10 years) for the previous month and adding 100 basis points. See Article 16 of the main text. The usual practice in the regional aircraft sector is to use US dollars.

[10] See [], dated 21 March 2001 [hereinafter "[] Declaration"] (Confidential Exhibit CDA-1) and Letter from [], operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001 [hereinafter "Air Wisconsin Letter"] (Exhibit CDA-2).

> to extend negotiations as much as possible, the MFA contracted big advocacy companies abroad specialized in international trade."[11]

16. Almost three years of WTO litigation had demonstrated that Brazil would not be bound by its WTO commitments. Four panel and Appellate Body decisions had confirmed that PROEX is an illegal export subsidy and the DSB had twice, unsuccessfully, called for Brazil to withdraw its illegal PROEX subsidies. Further, over the previous year, Brazil had rebuffed efforts by Canada to reach a negotiated solution committing both countries to financing on either market or Arrangement terms. Experience with PROEX I and II had shown that even if Brazil's export subsidies were ruled illegal, once it had made financing commitments Brazil would not cease its export subsidies on aircraft still to be delivered.

17. Thus, it was clear that, at best, WTO dispute settlement proceedings could afford limited relief with respect to the Air Wisconsin sale. Canada would permanently lose the sale unless it could match Brazil's offer. Accordingly, the Canadian government decided on a two-track approach to try to forestall future illegal subsidization by Brazil and to preserve competition for the Air Wisconsin sale. As one-track, in January 2001, Canada commenced a new Article 21.5 proceeding to test Brazil's assertions that PROEX III conforms to the recommendations and rulings of the DSU and the SCM Agreement. That Article 21.5 panel is scheduled to issue its interim report on 20 June 2001 and to circulate its final report by the end of July of this year.

18. The second track was to use the Canada Account programme to support Bombardier's bid for the Air Wisconsin contract with financing that matched the support that Brazil was offering to Air Wisconsin. Such matching, including non-identical matching, is permitted under the OECD Arrangement and, in Canada's view, by the exception in the second paragraph of Item (k) to Annex I of the SCM Agreement. Canada also reasons that if Brazil is found in the current Article 21.5 proceeding to be correct in its claims that PROEX III conforms to the SCM Agreement, then Canadian support on a matching basis will also conform to the SCM Agreement without the need to invoke the second paragraph of Item (k).

C. THE EXPORT DEVELOPMENT CORPORATION

19. Many of Brazil's allegations in this dispute are directed at Canada's Export Development Corporation ("EDC"). EDC is incorporated under the laws of Canada and is wholly-owned by the Government of Canada. It operates on commercial principles with the objectives of:

> (a) supporting and developing, directly or indirectly Canada's export trade; and
>
> (b) supporting and developing, directly or indirectly Canada's capacity to:
>
> (i) engage in exports, and
>
> (ii) respond to international business opportunities.[12]

20. EDC's activities on its own account are referred to as "Corporate Account" activities. EDC may also undertake and administer financing transactions that it would not otherwise undertake provided that the Government of Canada deems them to be in the national interest. Obligations under such activities are funded by the Government of Canada and the risk is assumed directly by the Government of Canada. This is the so-called "Canada Account". Canada Account transactions will

[11] Guilherme Barros, "Canada can retaliate against Brazil by US$1.3 billion" *Folha de Sao Paulo* (22 August 2000) (Exhibit CDA-3).

[12] See *Export Development Act*, R.S.C. 1985, c. E-20, s. 10. (Exhibit BRA-17)

always be in compliance with the OECD Arrangement, as Canada committed in response to the DSB ruling of 20 August 1999 in *Canada – Aircraft I*.

III. RELEVANT FINDINGS IN *CANADA – AIRCRAFT I*

21. In its first submission, Brazil refers to findings by the panel and the Appellate Body in the various proceedings in C*anada – Aircraft I*. Some of the findings in that dispute are indeed relevant to the present dispute, including findings regarding the EDC's Corporate Account and Canada Account programmes.

22. In the original panel proceeding in *Canada – Aircraft I*, the parties and the panel distinguished between the EDC Corporate Account programme (which the panel referred to as the "EDC programme") and the Canada Account. Brazil challenged both programmes as *per se* (i.e. "as such") export subsidies and as applied in specific transactions.[13]

A. BRAZIL'S PER SE CLAIMS IN *CANADA – AIRCRAFT I*

23. Applying "the distinction that GATT/WTO panels have consistently drawn between discretionary legislation and mandatory legislation,"[14] the panel found that Brazil had failed to demonstrate that the Corporate Account, as such, mandates the grant of subsidies. It found that the Corporate Account programme in fact "constitutes discretionary legislation", since the legislation does not require Canada to grant illegal export subsidies in any circumstances. [15]

24. The panel made similar findings in the case of the Canada Account: "we find that Brazil has failed to demonstrate that the Canada Account programme as such mandates subsidies that are contingent upon export performance. Rather, the Canada Account programme constitutes discretionary legislation."[16] Brazil did not appeal these findings in respect of either Corporate Account or Canada Account and they were adopted unmodified by the DSB when it adopted the panel and Appellate Body reports on 20 August 1999.

B. CORPORATE ACCOUNT AS APPLIED IN *CANADA – AIRCRAFT I*

25. In support of its claims that the Corporate Account as applied provided prohibited export subsidies, Brazil in *Canada – Aircraft I* challenged certain forms of EDC financing assistance that it alleged were provided to the Canadian regional aircraft industry, including debt financing and loan guarantees.

26. In attempting to make out a case that Corporate Account debt financing constituted a benefit, Brazil relied on many of the same statements by officials and assertions about EDC's performance that it has again raised in this dispute. The panel found that "we do not believe that the evidence and arguments adduced by Brazil in respect of statements by EDC officials or EDC's overall financial performance demonstrates subsidized debt financing"[17] and that "Brazil has not demonstrated, on the basis of its arguments concerning statements by EDC officials and EDC's financial performance, that EDC debt financing generally confers a 'benefit'".[18]

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[13] *Canada – Aircraft I*, Panel Report, paras. 9.121, 9.130, 9.204 and 9.214.
[14] *Id*., para. 9.124.
[15] *Id*., para. 9.129.
[16] *Id*., para. 9.213.
[17] *Id*., para. 9.180.
[18] *Id*., para. 9.181.

27. In *Canada – Aircraft I*, Brazil also attempted to argue its case on the basis of evidence concerning certain transactions. In its arguments on debt financing and loan guarantees it relied on evidence that it has again referred to in this dispute, regarding two transactions, involving ASA and Comair respectively.

28. The panel in *Canada – Aircraft I* found that "Brazil's arguments concerning ASA provide no basis for finding that either this specific instance of EDC debt financing, or EDC debt financing in the regional aircraft sector generally, confers a 'benefit' within the meaning of Article 1.1(b) of the SCM Agreement,"[19] and that "the evidence adduced by Brazil concerning the ASA debt financing transaction in no way indicates that the general EDC debt financing policy of covering costs and a minimum risk margin has not been applied in the regional aircraft sector."[20]

29. In the case of Comair, the panel rejected "Brazil's allegation that EDC granted an export subsidy in the form of a loan guarantee to Comair in 1997."[21]

C. CANADA ACCOUNT AS APPLIED IN *CANADA – AIRCRAFT I*

30. Brazil also challenged the Canada Account programme as applied. The panel found that Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constituted prohibited export subsidies.[22] Canada then took measures intended to ensure that future Canada Account transactions in the regional aircraft sector would be in conformity with the interest rates provisions of the OECD Arrangement, and would therefore qualify for the "safe haven" of the second paragraph of Item (k) of Annex I to the SCM Agreement. In an Article 21.5 proceeding brought by Brazil, the panel found that the measures taken by Canada did not "ensure" this with respect to future transactions.[23] However, in the Article 21.5 proceeding, Brazil did not dispute that Canada had brought itself into compliance in respect of Canada Account transactions up to 18 November 1999. Accordingly, the panel did not consider further past Canada Account transactions.[24]

IV. LEGAL ARGUMENT

A. CANADA ACCOUNT "AS SUCH"

31. GATT/WTO panels have consistently drawn a distinction between discretionary legislation and mandatory legislation. Generally, it is not sufficient for a complaining Member to show that an impugned measure might allow the Member complained against to violate its WTO obligations but

[19] *Id*., para. 9.179.
[20] *Id*., para. 9.180.
[21] *Id*., para. 9.186.
[22] *Id*., para. 10.1(b).
[23] *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, adopted 4 August 2000, para. 6.1 [hereinafter "*Canada – Aircraft I*, Article 21.5 Panel Report"]. In rejecting an appeal by Brazil from the panel's finding that Canada had implemented another of the DSB's recommendations, the Appellate Body subsequently stated that the "ensure" standard applied by the panel "should be viewed with caution" because if read too literally, it 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." (*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, adopted 4 August 2000, para. 38 [hereinafter "*Canada – Aircraft I*, Article 21.5 Appellate Body Report"].)
[24] *Canada – Aircraft I*, Article 21.5 Panel Report, para. 5.57.

rather, that the measure required, or would require, the Member to violate its obligations in at least some circumstances.[25]

32. In the original *Canada – Aircraft I* panel decision, the panel found that the Canada Account programme constituted discretionary legislation because there was nothing to suggest that Canada Account must, in law, subsidize. Therefore, the panel found that it was not permitted to make any findings on the Canada Account *per se* and confined its analysis to claims concerning the actual application of the Canada Account programme.[26]

33. Some of Brazil's assertions in its first submission in this dispute seem to suggest again that Canada Account *per se* is a prohibited export subsidy.[27] However, the findings that Brazil relies on to support these assertions are findings on the Canada Account *as applied* in the regional aircraft sector.[28] Brazil presents no arguments or evidence that Canada Account *mandates* the granting of prohibited export subsidies (other than a misrepresented panel finding),[29] because the Canada Account indeed is not mandatory legislation. Nothing since the finding in *Canada – Aircraft I* has changed that. Brazil's allegations in respect of Canada Account are only relevant to an *as applied* challenge. Therefore, if Brazil is challenging Canada Account *as such*, that challenge must fail.

B. CORPORATE ACCOUNT "AS SUCH"

34. In this dispute it is unclear from Brazil's panel request and its first submission whether Brazil's new claims in respect of the EDC are restricted to certain forms of alleged EDC financial support for regional aircraft sales (as the title of this dispute would suggest), or extend to the EDC's alleged provision of unspecified "financial services" generally, as paragraphs 21 to 39 and 73 might suggest; whether it is the provision of these unspecified services to the regional aircraft industry that is being challenged (as paragraphs 40 to 70 might suggest); or even that the EDC itself is somehow prohibited, as paragraphs 71 and 72 ("EDC is Contingent upon Export") might suggest.

35. In its Request for Preliminary Rulings, Canada has addressed the prejudice caused by this lack of clarity and by Brazil's refusal to clarify its claims when requested to do so. Canada has explained in that submission why Brazil's claims regarding EDC do not meet the requirements of Article 6.2 of the DSU. However, pending the panel's ruling and as noted in the introduction, Canada will respond to what it understands to be Brazil's claims.

36. If Brazil is indeed challenging the EDC Corporate Account as such, Canada notes that, as the panel in *Canada – Aircraft I* found, the Corporate Account constitutes discretionary legislation. It does not in any way mandate subsidies inconsistent with the SCM Agreement and cannot be *per se* inconsistent with Articles 1 and 3 of the SCM Agreement.[30] It therefore is not surprising that Brazil has no evidence to support its claim.

37. In Sections III.A and B of its first submission (paragraphs 21 to 39), Brazil appears to be arguing that because the EDC is a governmental entity and as such does not pay income taxes, *any*

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[25] See *United States – Anti-Dumping Act of 1916*, Report of the Appellate Body, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, paras. 60 and 88.

[26] *Canada – Aircraft I*, Panel Report, paras. 9.208-9.213.

[27] Brazil's First Submission, paras. 74-81.

[28] In each paragraph that Brazil cites in footnote 107 of its first submission, the panel used the language "Canada Account debt financing *in issue*." [emphasis added]

[29] The actual finding reads "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft … ." See *Canada – Aircraft I*, Panel Report, para. 10.1(b). Brazil reads this as the whole of "Canada Account." (See Brazil's First Submission. para. 75.)

[30] See *supra*, para. 23.

financing by it constitutes a subsidy. There is no support for this argument in Article 1.1 of the SCM Agreement. Whether the EDC pays income taxes is irrelevant to the issue of whether it is granting a subsidy on aircraft exports, since the issue is not whether the EDC, as a public body, is, or is not, subsidized. Indeed, it would come as a great surprise to the many WTO Members who operate government financing agencies if those institutions were considered *per se* illegal under the SCM Agreement if they receive government support of any kind.

C. INVESTISSEMENT QUÉBEC "AS SUCH"

38. It is also unclear from Brazil's panel request and its first submission whether Brazil is challenging certain forms of Investissement Québec financing or is challenging Investissement Québec as such. If the latter, Brazil's own evidence demonstrates the broad mandate and discretion of Investissement Québec.[31] Investissement Québec is an agency established by *An Act Respecting Investissement-Québec and Garantie-Québec*[32] ("the Act"), which continues the Société de développement industriel du Québec.

39. As Brazil's own evidence at paragraph 84 of its first submission demonstrates, Investissement Québec's mandate and powers are broad. Investissement Québec's "general mission" to which Brazil refers, in part, at paragraph 83 of its first submission, is set out in Article 25 of the Act. Article 25 provides:

> 25. The mission of the agency is to facilitate the growth of investment in Québec and thus contribute to the economic development of Québec and the creation of employment opportunities.
>
> The agency shall centralise and consolidate the actions of the State to seek out, promote and support investment, and shall become the main channel for communications with the enterprises concerned.
>
> The agency shall strive to stimulate domestic investment and to attract investors outside Québec. It shall promote Québec among investors as a propitious location for investment, offer investors orientation services to guide them in their dealings with the Government, and provide them with financial and technical support.
>
> The agency shall participate in the growth of enterprises, in particular by facilitating research and development and export activities.
>
> The agency shall also work to retain current investment in Québec by providing support to enterprises established in Québec that show particular dynamism or potential.

40. Article 28 of the Act provides:

> 28. The Government may, where a project is of major economic significance for Québec, mandate the agency to grant and administer the assistance determined by the Government to facilitate the realisation of the project. The mandate may authorise the agency to fix the terms and conditions of the assistance.

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[31] Brazil's First Submission, paras. 83-84.

[32] *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 28. (Exhibit BRA-18)

41. Article 34 of the Act provides:

> 34. The agency may provide technical services to an enterprise, a government department or body or a state-owned enterprise, in particular in the field of financial analysis, credit arrangement and portfolio management.

42. As these articles demonstrate, Investissement Québec's mandate and discretion is very broad. Nothing in the Investissement Québec Act mandates it to provide financing at all. Nothing mandates it to provide financing that would confer a "benefit" within the meaning of Article 1 of the SCM Agreement. Nor is the financing it does provide made contingent upon exportation. Brazil has offered no evidence to support any claim that Investissement Québec is a prohibited export subsidy as such because there is no evidence.

D. CANADA ACCOUNT – THE AIR WISCONSIN TRANSACTION

(i) Canada Offered Financing on a Matching Basis to Air Wisconsin in Response to Brazil's Offer.

43. In late October 2000, Canada learned that Brazil was prepared to finance the sale of Embraer regional jets to Air Wisconsin on below-market terms. The information indicated that Brazil was offering [].[33]

44. The information Canada was receiving about the PROEX offer to Air Wisconsin was consistent with evidence that Brazil was continuing to offer prohibited export subsidies generally and in specific transactions. At approximately the same time as the PROEX offer was made to Air Wisconsin, Brazil made similar offers of PROEX support in the context of the campaigns for the sale of regional aircraft to SA Airlink, a South African airline and Japan Air System.[34]

45. Canada's information was also consistent with a statement made by Brazil's then foreign minister the week after Canada learned of Brazil's offer to Air Wisconsin, regarding the manner in which Brazil intended to apply PROEX: "For us, the interest rate is OECD rate, the coverage is 100 per cent and there are no limits on the length of the terms."[35]

46. In the light of Brazil's below-market financing offer to Air Wisconsin, Canada had no choice but to offer Air Wisconsin debt financing on a matching basis.[36] Therefore, Canada offered [] with a repayment term of [] years and a loan-to-value ratio ("LTV") of [] per cent.[37] As a pre-condition to the financing, Canada required Air Wisconsin to confirm in writing that Canada's offer was valued by Air Wisconsin as no more favourable, viewed in its entirety, than that offered by Brazil. Air Wisconsin provided written confirmation on March 20, 2001.[38]

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[33] [] Declaration (Confidential Exhibit CDA-1) and Air Wisconsin Letter (Exhibit CDA-2).

[34] See Declaration of [], dated 21 March 2001 and Declaration of [], dated 20 March 2001. (Confidential Exhibits CDA-4 and CDA-5)

[35] See M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Econômico* (30 October 2000). (Exhibit CDA-6).

[36] In the Arrangement context, "matching" refers only to the matching of "official support" offered by another government through the provision of "official support" by the matching Participant. The matching need not be term-for-term identical, i.e., it may be non-identical matching, because it is often impossible – due to confidentiality commitments – to know the precise terms of the initiating offer (as in this case). For new aircraft except large aircraft, the applicable matching provision of the Arrangement is Article 25 of Annex III.

[37] Air Wisconsin will have the option to choose between [] or a []. In the case of a [] structure, with respect to [] aircraft, the Government of Quebec is providing a guarantee to the equity investor for an amount equal to [] per cent of the sale price of each aircraft.

[38] Air Wisconsin Letter (Exhibit CDA-2).

(ii) The Air Wisconsin Transaction Qualifies for the "Safe Haven" of the Second Paragraph of Item (k).

47. The Air Wisconsin transaction is consistent with Canada's SCM Agreement obligations because Canada is merely matching Brazil's offer in a manner consistent with the "interest rates provisions" of the Arrangement. Canada's offer on a matching basis thus falls within the exception of the second paragraph of Item (k) in Annex I to the SCM Agreement.

48. Canada is aware that the *Canada – Aircraft I* Article 21.5 panel opined as to which provisions of the Arrangement would constitute "interest rates provisions". It did so on the theory that its mandate was to determine what was necessary to "ensure" compliance. Subsequently, the Appellate Body stated that this standard "should be viewed with caution".[39] Moreover, the panel offered its opinion in the absence of an actual disputed transaction.

49. In Canada's view, the correct interpretation of the "interest rates provisions" includes matching. Matching in the context of the OECD Arrangement qualifies for the "safe haven" because the matching provisions of the Arrangement, i.e., Article 29 of the main text and Articles 25 and 31 of Annex III, are in "conformity" with the "interest rates provisions" and indeed are themselves "interest rates provisions." A body of disciplines on matching has been developed in the Arrangement in order to "govern" this practice. In particular, Articles 50 through 53 of the main text set out matching procedures. The mere existence of this body of disciplines demonstrates that matching is a legitimate exercise that is permitted by, and conforms to, the OECD Arrangement.[40]

50. Accordingly, because Canada's action with respect to Air Wisconsin was on a matching basis as expressly permitted by the OECD Arrangement,[41] the transaction qualifies for the "safe haven" in the second paragraph of Item (k) and is not considered an export subsidy prohibited by the SCM Agreement.

(iii) Matching is in Conformity with the "Interest Rates Provisions" of the OECD Arrangement.

51. 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 credit subsidy prohibited by" the SCM Agreement.[42]

52. The *Canada – Aircraft I* Article 21.5 panel found that some matching – but not all – was, by the OECD Arrangement's own terms, not in "conformity" with the provisions of the OECD Arrangement.[43] Essentially, the panel equated matching, in some circumstances, to a derogation.[44] Canada does not share this view.

53. Matching is specifically permitted by Article 29 as a response to an "initiating offer" that may or may not comply with the OECD Arrangement. The *Canada – Aircraft I* Article 21.5 panel agreed. It stated at paragraph 5.124:

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[39] *Canada – Aircraft I*, Article 21.5 Appellate Body Report, para. 38.

[40] The Appellate Body in *Brazil – Aircraft*, at para. 184, mentioned the possibility of using the "matching" provisions of the OECD Arrangement.

[41] See note 36, *supra*.

[42] See *Canada – Aircraft I*, Article 21.5 Panel Report, para. 5.78.

[43] *Id*., paras. 5.124-5.125.

[44] *Id*.

> Thus, if a country offers terms that are within permitted variations, … any matching of those terms … "complies" [with the Arrangement].

54. In the next paragraph, the *Canada – Aircraft I* Article 21.5 panel stated:

> … Article 29 further provides that if an initiating offer "*does not comply* with the Arrangement", competing Participants are permitted to match those non-complying terms. [underlining added][footnote omitted]

55. Yet, the panel then reasoned that this latter matching – which is explicitly permitted by the Arrangement – somehow "departs from" the Arrangement and is therefore a derogation.[45] Matching cannot be "permitted" by the Arrangement and at the same time "depart from" the same Arrangement. If the Arrangement permits it, it "conforms" to the Arrangement by its own terms. If the Arrangement does not permit it, it does not "conform" to the Arrangement by its own terms.

(a) Matching is an "Interest Rates Provision"

56. The most logical interpretation of the term "interest rates provisions" used in Item (k) would include all substantive provisions in the OECD Arrangement that determine what interest rates are permitted, and that affect what the interest rate and what the amount of interest will be, in a given transaction, but would exclude procedural requirements with which a non-Participant inherently could not comply.[46]

57. Matching within the context of the OECD Arrangement provides one alternative permitted way of determining an interest rate and is consistent with the Arrangement. Therefore, matching is itself an "interest rates provision."[47]

(b) Matching is Consistent with the Object and Purpose of the SCM Agreement

58. The SCM Agreement is based on the premise that some forms of government intervention distort international trade, some have the potential to distort, and still others do not distort at all. The disciplines imposed by the SCM Agreement reflect this accepted approach, commonly known as the "traffic light approach":[48] trade distorting subsidies are to be prohibited outright (red light); potentially trade distorting subsidies are to be disciplined *if* they cause distortions in the market (amber); non-trade distorting subsidies are not subject to disciplines (green). Hence the prohibition on

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[45] *Id*.

[46] The matching procedures are Articles 50 – 53 of the main text of the Arrangement. In Canada's view, the right to offer terms on a matching basis is available to all Members. If the matching transaction of a non-Participant were challenged at the WTO and found to provide a prohibited export subsidy, the "safe haven" of Item (k) would be available to that non-Participant, provided that the matching was undertaken in good faith and on the basis of reasonable due diligence.

[47] Both the US and the EC support the view that the matching provisions of the Arrangement constitute "interest rates provisions" within the meaning of the second paragraph of Item (k). (See *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5*, Third Party Submission of the United States, para. 23; and Third Party Submission by the European Communities, paras. 34-39. (Exhibits CDA-7 and CDA-8))

[48] See Negotiating Group on Subsidies and Countervailing Measures, *Communication from Switzerland*, MTN.GNG/NG10/W/17, 1 February 1988, pp. 1-2; Negotiating Group on Subsidies and Countervailing Measures, *Meeting of 1-2 June 1988: Note by the Secretariat*, MTN.GNG/NG10/7, 8 June 1988; and *Trade Negotiations Committee Meeting at Ministerial Level, Montreal, December 1988*, MTN.TNC/7(MIN), 9 December 1988, pp. 18-20. (Exhibits CDA-9 – CDA-11)

export subsidies, the disciplines on actionable subsidies if they cause serious prejudice, and the absence of disciplines on certain types of research and development subsidies.[49]

59. Although the SCM Agreement disciplines trade distorting subsidies, the prospective nature of the dispute settlement remedies means that – in the absence of matching – illegal subsidizers will have a perpetual advantage. The events of this case provide practical evidence of why the SCM Agreement includes matching. Despite a DSB ruling that Brazil withdraw its prohibited export subsidies, Brazil has consistently and knowingly refused to cease illegal subsidies under "commitments" it made prior to the compliance date, i.e., 18 November 1999. This assures the regional aircraft market that it will be able to keep any subsidies that Brazil offers to secure a sale, which in turn means that Canada has no chance and will be out of the market for that sale unless it offers terms that are similar to Brazil's on a matching basis.[50]

60. Finally, it is significant that the Illustrative List of the SCM Agreement was carried over from the Tokyo Round Subsidies Code. After more than ten years of negotiations, the OECD Arrangement was adopted in 1978. In 1979, the Tokyo Round Subsidies Code was agreed together with other Tokyo Round Agreements. Given that the signatories of the GATT Subsidies Code were at the same time participants in the OECD Arrangement, it is illogical that the signatories of the GATT Subsidies Code would have allowed matching in the Arrangement but then would have forbade it in the subsidies agreement one year later.

E. EDC CORPORATE ACCOUNT FINANCING

61. If Brazil is challenging specific types of Corporate Account financing, it bears the burden of establishing that those types of EDC financing constitute a subsidy within the meaning of Article 1 of the SCM Agreement that is prohibited by Article 3. In particular, Brazil must establish a *prima facie* case that EDC financing is a subsidy. This requires it to show that there is a financial contribution by a government or a public body that thereby confers a benefit.[51] Brazil must do this for each application of the EDC Corporate Account that it is challenging.

62. Article 1 of the SCM Agreement makes clear that for a subsidy to exist, there must be both a financial contribution by a government or a public body (Article 1.1(a)(1); and a benefit must *thereby* be conferred (Article 1.1(b)). Read together, these provisions require a causal link between a "benefit" and the fact that the financial contribution is made by a public body. In the case of EDC Corporate Account financing, Brazil has failed to make even a *prima facie* case of this link.

(i) Financial Contribution

63. In section III.C of its first submission, Brazil asserts that EDC offers "a wide range of financial services" and that, all of them, apparently, "constitute financial contributions within the meaning of Article 1.1(a)(1) of the SCM Agreement".[52] Brazil does not seek to substantiate this argument except in respect of loans and loan guarantees, which it considers to fall within Article 1.1(a)(1)(i) of the SCM Agreement.[53] Canada agrees that loans and loan guarantees may be financial contributions within the meaning of Article 1.1(a)(1)(i). However, Canada does not agree with Brazil's assertion that those same loans and loan guarantees are also financial contributions within the meaning of Article 1.1(a)(1)(iii).[54]

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[49] The exemptions for research and development have lapsed.
[50] See note 36, *supra*.
[51] *Canada – Aircraft I*, Panel Report, paras. 9.158-9.159.
[52] Brazil's First Submission, para. 40.
[53] *Id*., paras. 44, 45.
[54] *Id*., para. 46.

64. In the same section, Brazil has incorrectly identified two transactions as constituting financial contributions involving EDC Corporate Account. One of these is Midway. The EDC has not participated in the Midway transaction. The other is the Air Wisconsin sale.[55] Canada made clear in public statements[56] and again during the consultations in this dispute that financing by the Canadian government for the Air Wisconsin transaction would be provided through the Canada Account alone. Throughout the course of the *Canada – Aircraft I* dispute, Brazil and Canada both distinguished between Canada Account transactions and EDC Corporate Account financing. Brazil has again drawn this distinction in this dispute. Any allegations that EDC Corporate Account financing is involved in either a Midway sale or the Air Wisconsin transaction are false.

65. Brazil has also alleged incorrectly that Comair received loan guarantees under EDC Corporate Account.[57] Brazil relies for this allegation on essentially the same evidence that it put before the *Canada – Aircraft I* panel.[58] As previously noted, Canada denied and the panel rejected Brazil's allegation in *Canada – Aircraft I*.[59] Canada again denies Brazil's allegation.

(ii) Corporate Account Financing For Regional Aircraft Does Not Confer A Benefit

66. The Appellate Body has found that whether a benefit is conferred for the purposes of Article 1.1(b) can be determined by whether the financial contribution is on terms more favourable than those available to the recipient in the market.[60]

67. Since 1998, all Corporate Account financing for regional aircraft has been provided on a commercial basis. Therefore it does not confer a benefit.[61] In both the *Canada – Aircraft I* dispute and in the first Article 21.5 proceeding in *Brazil – Aircraft*, Canada described EDC's practices as follows:

> The EDC operates on commercial principles. This means that in providing financing in sales transactions, the terms it offers to prospective purchasers are "priced" commercially. The EDC provides financing at market rates by setting its interest margins to reflect credit risk in accordance with market principles. The EDC's interest rates reflect commercial benchmarks and interest rate margins that are in accordance with commercial credit ratings provided by rating agencies such as Moody's or Standard & Poor. Where commercial credit ratings are not available from rating agencies, the EDC uses internal credit ratings determined in accordance with prudent commercial practices. Like several other international financial institutions, the EDC's internal credit ratings are based upon the result of analyses using a sophisticated computer programme, *LA Encore.* This programme is employed for the same purpose by other major financial institutions, such as Lloyd's Bank and Barclays Bank in the United Kingdom.
>
> In terms of the pricing process, the EDC's transportation group has a committee that reviews and approves the pricing on all transactions in the civil aircraft sector. In

[55] *Id*., paras. 1, 3, 4, 43 and 44.

[56] See e.g., "Bombardier Snags $2.4 B order from US airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001 and "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001. (Exhibits BRA-2 and BRA-3)

[57] Brazil's First Submission, paras. 43 and 45.

[58] *Id*., para. 43; *Canada – Aircraft I*, Panel Report, para. 6.94 and fn. 223.

[59] Panel Report, para. 9.186.

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

[61] As described in footnote 5, *supra*, prior to 1998, the Corporate Account was used for [] official support transactions, involving [] aircraft. These transactions were consistent with the OECD Arrangement.

> setting this pricing, EDC compares what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*. The EDC then prices according to that benchmark. In the absence of this benchmark, the EDC compares the relevant borrower to borrowers of comparable credit standing in the civil aviation sector for whom a similar credit history exists; the EDC then prices according to this alternative benchmark.[62]

(a) The OECD Arrangement is Relevant Only If a Subsidy Has Been Found

68. In the absence of evidence of "benefits", at paragraphs 47 to 59 of its first submission, Brazil resorts to sophistry. Its argument seems to be that the OECD Arrangement determines what is a benefit by determining, at least presumptively, what is at market. According to Brazil, if EDC transactions do not conform to the OECD Arrangement they are not at market and confer a benefit.

69. However, under the SCM Agreement, the Arrangement becomes relevant only once a subsidy has been found to exist and the analysis turns to whether that otherwise prohibited subsidy is permitted under the "safe haven" of the second paragraph of Item (k) in Annex I or is "used to secure a material advantage in the field of export credit terms" under the first paragraph of Item (k).[63] Brazil's argument is circular. It relies on a standard that requires the existence of a subsidy in order to assess whether a subsidy exists.

(b) Rates below the Arrangement's CIRR Need Not Confer a Benefit

70. At paragraphs 56 and 57 of its first submission, Brazil makes much of Canada's statement in the *Brazil – Aircraft* Article 21.5 panel proceeding that it has, on occasion, provided export credits at interest rates that, despite being below the CIRR, were nevertheless commercial and did not confer a "benefit" within the meaning of Article 1. The Appellate Body indicated in *Brazil – Aircraft* that a net interest rate below one of the interest rates provisions of the Arrangement, the CIRR, is a positive indication that the government payment in a particular transaction has been used to secure a material advantage.[64] However, it subsequently emphasized that:

> … the CIRR is "*one example*" of a "market benchmark" that may be used to determine whether a "payment" is used to "secure a material advantage". 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.[65] [emphasis in original]

71. Thus, Brazil is misguided in its attempt to imply something sinister about Canada's statement that it has, on occasion, provided export credits, on commercial terms, at interest rates below the CIRR. Canada made this statement in response to the panel's question: "Has any Canadian government agency (including the Export Development Corporation), since 1 January 1998, in respect of regional aircraft, (a) provided fixed interest-rate export credits at interest rates below CIRR?" Canada answered in part:

> Yes. Due to the time delay in the construction of CIRR (as discussed below), there were instances where certain of EDC's financing transactions were at a rate less than the CIRR applicable on the date the transaction closed. However, the interest rates charged by EDC for such transactions were market-based and commensurate with the

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[62] See e.g., *Brazil – Aircraft*, Article 21.5 Panel Report, p. 91, included in Brazil's Exhibit BRA-27.
[63] *Brazil – Aircraft*, Appellate Body Report, paras. 180-181.
[64] *Id*., para. 182.
[65] *Brazil – Aircraft*, Article 21.5 Appellate Body Report, para. 64.

> risk associated with the particular borrower, and said transactions included customary collateral security protection.[66]

72. Contrary to Brazil's assertion in paragraph 57 of its first submission, Canada did explain why these instances were commercial. As the Panel noted at paragraph 6.102 of its Report, "Canada explains in some detail that the situation of below-CIRR market rates can arise because the CIRR lags behind the market."[67] Canada stated:

> A meaningful comparison of market transactions to CIRR is difficult due to the fact that the CIRR is a constructed rate, while commercial aircraft transactions are priced at commercial rates available at the time of the specific transaction. To recall, the CIRR is determined by taking the average of the 7-year Treasury rate (in the case of deals with repayment terms up to 10 years) for the previous month and adding 100 bps. For example, the CIRR for the period 15 September – 15 October would be constructed using the average of the 7-year Treasury for the month of August, plus 100 bps. Carrying on with the example, the result of this calculation is that the CIRR applicable to transactions closing during the period from 15 September through 15 October would close using a rate that was calculated using the average of the applicable Treasury rate during August, i.e. up to two months earlier. To an entity that operates on the basis of commercial principles, the calculation of the CIRR is such that it would not be considered a reliable reflection of current market conditions.[68]

73. On the basis of Canada's statements, the Panel concluded that: "payments in respect of export credit financing for regional aircraft at below-CIRR interest rates are not necessarily used to secure a material advantage in the field of export credit terms".[69]

(c) The Transactions Described By Brazil Do Not Demonstrate a Benefit

74. The weakness of Brazil's argument that the Arrangement as applied in Item (k) somehow determines what is at market – and therefore a "benefit" for the purposes of Article 1 – is demonstrated by paragraph 59 of its first submission.

75. In paragraph 59, Brazil cites five regional aircraft financing transactions for the proposition that "Canada routinely exceeds the *Arrangement's* 10-year maximum repayment term." Canada has already explained that Brazil has incorrectly identified EDC's involvement in two of these transactions, Midway and Comair.[70] More importantly, the terms described in the five transactions vary between [] and [] years. Standard commercially available financing terms for regional aircraft sales range from 10 to 18 years.[71] That is, marketplace financing for regional aircraft routinely exceeds 10 years. Thus, the terms Brazil has identified are all entirely within the ordinary commercial range. This evidence does not show that "Canada" is providing a "benefit" let alone a "material

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[66] *Brazil – Aircraft*, Article 21.5 Panel Report, Annex 1-4, Responses by Canada to Questions of the Panel, Canada's Responses to the Panel's Questions Posed on 3 February 2000, Response to Question 4(a), p. 82.

[67] *Brazil – Aircraft*, Article 21.5 Panel Report, para. 6.102.

[68] *Brazil – Aircraft*, Article 21.5 Panel Report, Annex 1-4, Responses by Canada to Questions of the Panel, Canada's Responses to the Panel's Questions Posed on 3 February 2000, Response to Question 4(a), p. 82.

[69] *Brazil – Aircraft*, Article 21.5 Panel Report, para. 6.103.

[70] See paragraphs 64 and 65, *supra*.

[71] See "CIT Structured Finance," Presentation to Aircraft Finance and Commercial Aviation Forum (February 2001). (Exhibit CDA-12)

advantage". On the contrary, it supports Canada's position that its regional aircraft financing is offered on market terms.[72]

76. Brazil also seeks to support its contention that EDC Corporate Account financing confers a benefit by raising the "matching" transaction to which Canada referred in *Brazil – Aircraft I*, and the Air Wisconsin transaction.[73] Both of these transactions involve the Canada Account and thus have no relevance for the Corporate Account. (As Canada has also explained, matching transactions, including Air Wisconsin, are permitted under the OECD Arrangement.)

(d) Generic Statements By the EDC and Its Officials Do Not Demonstrate a Benefit

77. At paragraphs 60 and 61 of its first submission, Brazil attempts to show that EDC programmes confer a "benefit" by relying on general statements from an EDC document that it previously submitted in *Canada – Aircraft I*. The statements are that "EDC complements the banks and other financial institutions but cannot substitute for them", and that "EDC's goal is to help absorb the risk beyond what is possible by other financial intermediaries". Nothing in these statements indicates that EDC provides "financial services" on non-market terms. The statements cited do not refer to specific "financial services", or to transactions, or even to "financial services" at all. As the panel found in *Canada – Aircraft I*, the answer to whether Corporate Account as applied confers a benefit cannot be inferred or extrapolated from the generic statements of the EDC or its officials.[74]

78. At paragraphs 62 to 67 of its first submission, Brazil seeks to argue, again on the basis of a statement by an EDC official, that Brazil put before the *Canada – Aircraft I* panel, that EDC financial contributions confer a benefit. In the statement, the official, Mr. Labbé, said, among other things, that "EDC's financing support gives Canadian exporters an edge". According to Brazil, this constitutes an acknowledgement that EDC provides a benefit within the meaning of Article 1 of the SCM Agreement.

79. However, the panel in *Canada – Aircraft I* found that this statement "provides no firm guidance as to whether EDC provides exporters with an 'edge' through subsidization."[75] Moreover, the panel did not accept the interpretation of the statement advanced by Brazil. The panel inferred that "the relevant 'edge' is the ability of the EDC officials to assemble better structured financial packages on the basis of their knowledge and expertise."[76] The Appellate Body concluded that this inference was neither illogical nor unreasonable.[77]

80. Now Brazil seems to be arguing that even if this is so, it is still evidence of a "benefit" because "[g]overnment provision of ability, knowledge and expertise through financial services" is a financial contribution, and moreover, the provisions of this ability, knowledge and expertise through financial services superior to those the recipient could otherwise obtain in the market also constitutes the conferral of a benefit.[78]

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[72] In fact, the "terms" Brazil has identified in paragraph 59 appear to be *lease* terms – that is, the duration of aircraft leases – rather than loan *repayment* terms. In aircraft financing transactions, the term of loan repayment may run as long as the term of the lease but it will not be longer. Thus, Brazil may have erroneously overstated somewhat the repayment terms in these transactions. However, *even overstated*, these terms are still within the ordinary commercial range for repayment terms.

[73] Brazil's First Submission, paras 57, 58.

[74] *Canada – Aircraft I*, Panel Report, paras. 9.162-9.165.

[75] *Id*., para. 9.163.

[76] *Id*.

[77] *Canada – Aircraft I*, Appellate Body Report, para. 213.

[78] Brazil's First Submission, para. 66.

81. There are two basic problems with this argument, one procedural, the other substantive. The procedural problem, which is addressed in Canada's Preliminary Submission at paragraph 52, is that this argument relies on Article 1.1(a)(1)(iii) of the SCM Agreement. Brazil asserts that "[t]his proceeding explicitly involves both subparagraph (i) and subparagraph (iii)" of that Article.[79] However, contrary to Article 6.2 of the DSU, Brazil failed to make this explicit at all, either in its request for a panel (which referred to no more than "Article 1" generally) or when Canada asked for clarification of Brazil's claims.

82. The substantive problem is that Brazil offers no evidence that, even if the "ability, knowledge and expertise" required to develop a financial package is a financial contribution", it confers a "benefit" within the meaning of Article 1 of the SCM Agreement. Services such as "ability, knowledge and expertise" are paid for by the recipient as part of the price of the financial package. Brazil has offered no evidence that those services as such are priced below market and are therefore a "benefit".

83. It appears that Brazil tries to escape this result by interpreting Article 1.1(a)(1)(iii) as requiring as a precondition that a benefit already be conferred under Article 1.1(a)(1)(i) through the provision of financial packages superior to those the recipient could otherwise obtain in the market. As Canada has shown, Brazil has not demonstrated that EDC provides financial packages that are better than what a recipient could otherwise obtain in the market. Thus, Brazil's argument is circular here too. It assumes, falsely, that a benefit is conferred by a "financial package" to argue that a benefit is conferred by the "ability, expertise and knowledge" used to develop that package.

(e) Brazil Has Not Shown That Loan Guarantees Confer A Benefit

84. Lastly, Brazil asserts, at paragraphs 68 to 70 of its first submission, that loan guarantees provided by EDC confer a benefit. Brazil appears to be asserting that all government loan guarantees necessarily confer a benefit. Brazil does not explain how its position – which would come as a surprise to most government export credit agencies – is consistent with the definition of "benefit" adopted by the Appellate Body. Brazil has failed to recognize that most guarantors, including EDC, charge fees for their guarantees.

(iii) Conclusion

85. In sum, having failed to show that Corporate Account as such constitutes a prohibited export subsidy, Brazil has also failed to make out a *prima facie* case that the application of Corporate Account financing confers a benefit. Brazil has not demonstrated, either by reference to the statements of EDC officials or to transactions, that Corporate Account financing is applied to confer a benefit. Corporate account loans and loan guarantees are not offered on terms more favourable than those available in the market. They do not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement and therefore do not amount to subsidies. As Brazil has failed to show that Corporate Account financing amounts to a subsidy, the issue of export contingency is moot.

F. INVESTISSMENT QUÉBEC FINANCING

86. The onus lies with Brazil to make out a *prima facie* case that Investissement Québec financing constitutes a subsidy within the meaning of Article 1 of the SCM Agreement. In particular, Brazil must make out a *prima facie* case of the existence of financial contributions by Investissement Québec that thereby confer a benefit on the recipient.

[79] *Id.*, para. 65.

(i) Financial Contribution

87. The only financial contributions by Investissement Québec that Brazil appears to allege are the provision of "loan guarantees" and "first loss deficiency guarantees" or "equity guarantees".[80] The provision of such guarantees by a government or public body constitutes potential direct transfers of funds or liabilities within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement and would therefore be a "financial contribution".

(ii) Brazil Has Failed to Show the Existence of a "Benefit"

88. As the Appellate Body has found, the existence of a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement can be determined by whether the financial contribution is on terms more favourable than those available to the recipient in the market.[81] Brazil has not demonstrated this. Instead, its only arguments appear to be that equity guarantees "do not even appear to be available commercially" or "are not available in the market",[82] and that government loan guarantees necessarily confer a benefit.[83]

89. The first of these arguments is surprising coming from Brazil. Equity guarantees are not only offered commercially in the aircraft sector but they have been used to support the sale of Embraer regional aircraft. For example, according to the Preliminary Prospectus issued in conjunction with the financing of a 1997 sale of Embraer EMB-145 regional jets for use by Continental Airlines, the structure of the transaction includes an equity guarantee by the engine supplier Rolls-Royce.[84]

90. Moreover, as Brazil recognizes at paragraph 88 of its first submission, leveraged lease transactions, which often include first-loss deficiency guarantees, are hardly "unusual". They are a commonplace aircraft financing structure based on the tax laws of certain jurisdictions.

91. Nor has Brazil demonstrated that Investissement Québec loan guarantees confer a "benefit". As Canada noted above with respect to Brazil's Corporate Account arguments, Brazil does not explain how its position – which would come as a surprise to most government export credit agencies – is consistent with the definition of "benefit" adopted by the Appellate Body. Brazil has failed to recognize that most guarantors, including Investissement Québec, charge fees for their guarantees.

(iii) Brazil Has Failed to Demonstrate Contingency Upon Exportation

92. Investissement Québec financing for aircraft sales is provided pursuant to section 28 of the Investissement Québec Act. As noted, Section 28 provides that:

> The Government may, where a project is of major economic significance for Quϑbec, mandate the agency to grant and administer the assistance determined by the

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[80] At footnote 131 to its First Submission, Brazil appears to imply that Investissement Québec may have offered residual value guarantees on Bombardier regional aircraft sales. Investissement Québec has never provided residual value guarantees.

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

[82] Brazil's First Submission, para 95.

[83] Brazil's First Submission, para. 96.

[84] Continental Airlines, Preliminary Prospectus, 16 October 1997 SEC Filing 424(b)3, cited from www.sec.gov, p.S-33 (Exhibit CDA-13). Also available at www.continental.com/corporate under Investor Relations/SEC Filings.

> Government to facilitate the realization of the project. The mandate may authorize the agency to fix the terms and conditions of the assistance.[85]

93. Section 28 of the Act is used for many types of projects, whether or not they have export potential. Nevertheless, Brazil argues, on the basis of Investissement Québec regulations, that Investissement Québec financing "is contingent in law upon export".[86] However, the programmes described in the decrees to which Brazil refers, 572-2000 and 841-2000, have nothing to do with aircraft sales financing and are not used for aircraft sales financing.[87]

94. Furthermore, Brazil appears to have misread Decree 572-2000. That decree states that funding can be for domestic or export projects but "exportation" as it refers to sale of goods refers to sale outside of Quebec. This, of course, does not mean that funding under the decree must be for sales outside of Quebec but that funding of export projects involving sales of goods must involve sales outside of Quebec. That is, "export projects" can include purely domestic sales to other parts of Canada as well as exports outside of Canada. Brazil's conclusion, that Investissement Québec financing for aircraft sales is contingent in law upon export performance, rests on the misreading of inapplicable decrees.

95. Nor do the remainder of Brazil's arguments support its claim. Brazil contends, at paragraph 101 of its first submission, that virtually all of Bombardier's production is exported and that this demonstrates "the *de jure* export contingency" of both a loan guarantee fund established for Bombardier as well as equity guarantees. Brazil has failed to show that either loan guarantees or equity guarantees offered by Investissement Québec are subsidies. They are not, but even if they were, Brazil has failed to establish their *de jure* export contingency.

96. According to the Appellate Body: "… the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'."[88] A subsidy is contingent "in law" upon export performance "when the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure".[89] Brazil failed to identify any legal instrument from which the export contingency of Investissement Québec financing can be demonstrated, nor does any such instrument exist. At most, Brazil has shown that some of Investissement Québec's financing *involves* export sales. This in no way makes Investissement Québec financing contingent in law upon export performance.[90]

(iv) Conclusion

97. Brazil has failed to show that any of Investissement Québec's financing either confers a benefit or is contingent upon exportation. It has therefore failed to make out even a *prima facie* case that Investissement Québec financing is a prohibited export subsidy.

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[85] *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 28. (Exhibit BRA-18)

[86] Brazil's First Submission, para 97.

[87] *Id*., paras. 98-100.

[88] *Canada – Aircraft I*, Appellate Body Report, para. 166, citing with approval the panel's definition.

[89] *Canada – Measures Affecting the Automotive Industry*, Report of the Panel, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 100.

[90] Although Brazil has alleged only contingency in law, the mere fact that Investissment Québec financing involves export sales does not amount to contingency in fact either. (See *Canada – Aircraft I*, Appellate Body Report, para. 173.)

V. CONCLUSION

98. Brazil's claims in this dispute fall into two categories. On the one hand, it is challenging Canada's decision to offer financing to Air Wisconsin. Its claims in this regard are clear, but they ignore the fact that Canada is simply responding, on a matching basis, to a financing offer that Brazil made to Air Wisconsin in an effort to win a sale for Embraer. Under the second paragraph of Item (k) in Annex I to the SCM Agreement, Canada is fully within its rights to do this. Canada asks that the Panel find accordingly.

99. On the other hand, Brazil appears to be challenging, at one or more levels, the EDC's Canada Account and Corporate Account programmes and Investissement Québec. As Canada has argued in its Preliminary Submission, the scope and substance of these claims are far from clear. They are contrary to Articles 6.2 or 21.5 of the DSU, or both. However, even on the merits, Brazil has failed in all instances to meet its burden of establishing a *prima facie* case. In its first submission, it has largely recycled allegations and evidence that have already been rejected by the panel and the Appellate Body in *Canada – Aircraft I*.

100. If Brazil is again challenging Canada Account or Corporate Account "as such", it has offered no basis, in law or in fact, for this Panel to revisit the findings of the *Canada – Aircraft I* panel that those programmes involve discretionary legislation. Brazil has also confirmed by its own evidence that Investissement Québec involves discretionary legislation. It too is not inconsistent "as such" with the SCM Agreement.

101. To the extent that Brazil is challenging types of Corporate Account or Investissement Québec financing generally or in respect of specific transactions, it has neither demonstrated nor can it demonstrate that this financing is a prohibited export subsidy. In the light of Brazil's failure to establish a *prima facie* case of inconsistency with the SCM Agreement, Canada asks that the Panel reject these claims as well.

ANNEX B-5

ORAL STATEMENT OF CANADA REGARDING JURISDICTIONAL ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

I. INTRODUCTION

1. In its Preliminary Submission of June 18, Canada asked the Panel to make a number of findings with respect to its jurisdiction. Today, Canada will respond to the points raised by Brazil in its reply submission of 22 June, and in so doing will summarize briefly its positions on these issues.
Certain of Brazil's Claims are Inconsistent with DSU Article 21.5

A. CERTAIN OF BRAZIL'S CLAIMS ARE INCONSISTENT WITH DSU ARTICLE 21.5

2. On reading the 22 June reply submission of Brazil, Canada learned – for the first time – that Brazil does not consider each of the numbered paragraphs in its Panel request to constitute separate claims. Instead, according to Brazil, it has made one "overarching claim" in paragraph 1 with respect to the Canada Account. Paragraphs 2, 3 and 4, argues Brazil, merely "explain the nature of that claim in more detail".

3. There is nothing in the Panel request that would indicate that Brazil has made one "overarching" claim in paragraph 1, of which paragraphs 2, 3 and 4 are mere subsets. Any reasonable construction of Brazil's Panel request supports the view that Brazil has made separate claims, duly set out in separate paragraphs. Nor did Brazil offer this or any other clarification when asked to do so by Canada.

4. Even if one were to accept the "overarching claim" theory, which Canada does not, this does not mean that any of its Claims are somehow immune from review from the Panel on jurisdictional grounds. Any part of the request for the Panel – whether part of an "overarching claim" or not – must comply with the mandatory requirements of the DSU, including Article 21.5 and 6.2. Any parts of the Panel request that fail to abide by these requirements should rightfully be considered by the Panel as outside its terms of reference.

5. This late addition of the "overarching claim" theory appears to be an attempt by Brazil to "cure" the deficiencies in its Panel request. As noted by Canada in its Preliminary Submission, it is not possible for a complaining party to use later submissions to "cure" defects in its Panel request.

6. Brazil states in paragraph 8 of its June 22 submission that it considered it "efficient" to forego Article 21.5. Brazil also states, in paragraph 9, that it considered it "preferable" to bring all its claims before this Panel, rather than reconvening the original Panel to consider compliance issues, and *de novo* proceedings to consider new claims. In Canada's view, the issue is demonstrably <u>not</u> what is "efficient" or "preferable." Rather, the issue is <u>what is permitted by the DSU</u>.

7. Disputes over implementation must be resolved through recourse to DSU Article 21.5. This is clear from the language of the provision, which states that disagreements over compliance "shall" be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original Panel.

8. If the intent of the drafters of the DSU had been different, they could have used different language. They could have said that such disputes "may" be decided through recourse to the original Panel. They did not. They could have said that such disputes "should" be decided through recourse to the original Panel. They did not. The ordinary meaning of Article 21.5 is that the complaining party "shall" have recourse to the original Panel where it is possible to do so. Brazil has not sought to argue that recourse to Article 21.5 was not possible in this case.

9. This interpretation is consistent with the practice of WTO Members to date, all of which, when seeking to resolve implementation disputes, have done so through recourse to Article 21.5. Brazil would be the first WTO Member to seek to resolve a compliance dispute through *de novo* Panel proceedings. To allow Brazil to proceed in this manner would be to ignore completely the mandatory language of Article 21.5.

10. Furthermore, Brazil is seeking to have the Panel rule on issues of implementation related to another dispute, with different terms of reference. The Panel has no jurisdiction to hear such claims.

11. The EC agrees that Article 21.5 is "not of a purely hortatory nature". However, Canada disagrees with the argument advanced by the EC that the word "shall" in Article 21.5 relates to "the use of the original panel once the option of an Article 21.5 panel has been chosen and not the use of the Article 21.5 procedure". The wording of Article 21.5 does not support such an interpretation. The relevant portion of Article 21.5 states that: "such dispute shall be decided through recourse to these dispute settlement procedures, *including wherever possible resort to the original panel*". If the drafters of the DSU intended to provide complaining parties with what the EC calls the "option" of an Article 21.5 procedure, they could easily have done so. Moreover, the use of the word <u>including</u> makes clear that the clause that follows this word ("wherever possible resort to the original panel") is subordinate to the mandatory language of the earlier part of the sentence ("shall be decided"). In other words, Article 21.5 requires that compliance disputes must be decided through recourse to the original panel, unless this is not possible.

12. Canada therefore maintains that Brazil has failed to respect the mandatory requirements of DSU Article 21.5.

B. CERTAIN OF BRAZIL'S CLAIMS ARE INCONSISTENT WITH DSU ARTICLE 6.2

13. DSU Article 6.2 requires that a request for the establishment of a Panel must, among other things, identify the specific measures at issue, and provide a brief summary of the legal basis of the complaint, sufficient to present the problem clearly.

14. The Appellate Body has made clear that compliance with Article 6.2 is a requirement of "due process" that is "fundamental to ensuring a fair and orderly conduct of dispute settlement proceedings".

15. As noted above, it is equally clear that the deficiencies in the Panel request, including a failure to meet the minimum standards of Article 6.2, cannot be "cured" by the subsequent submissions of the complainant.

16. The specific deficiencies of Brazil's request are set out in Canada's submission. Canada recalls that with respect to Claim 2, the EC also considers that this Claim fails to meet the standard

required by Article 6.2, on the grounds that Brazil was required to cite a covered agreement, and that "a panel report in an earlier dispute…does not amount to a covered agreement." Although the EC puts this forward as a different argument than that advanced by Canada, it would appear to be another way of explaining the test set out by the Appellate Body that the complaining party must identify the treaty provision alleged to have been violated.

17. In its 22 June arguments with respect to DSU Article 6.2, Brazil again advances its theory of the "one overarching claim".

18. As Canada stated with respect to Article 21.5, there is nothing in the Panel request that would indicate that Brazil has made one "overarching" claim. Brazil has made separate claims, duly set out in separate paragraphs. The late addition of an "overarching claim" theory appears to be an attempt by Brazil to "cure" the deficiencies in its Panel request.

19. Even if one were to accept the "overarching claim" theory, which Canada does not, this would in no way mean that either paragraph 1, or the subsequent elaborations set out in the succeeding paragraphs, do not need to comply with DSU Article 6.2. Whether part of an overarching claim or not, the due process requirements of Article 6.2 mandate that the request for the establishment of the Panel both identify the specific matters at issue, and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. As we have argued in our submission, Claims 1, 2, 5 and 7 fail to meet this standard.

20. In paragraph 21 of its June 22 submission, Brazil informs Canada that it is challenging measures "as such", and as applied, such as in the Air Wisconsin transaction. It adds that it is only concerned with the challenged measures with respect to their role in regional aircraft transactions.

21. Brazil cannot seek to "cure" the defects in its Panel request with such additional detail. The Panel request – as presented to the DSB - must be assessed against the requirements of Article 6.2, not in conjunction with whatever supplementary clarifications Brazil now wishes to present. Moreover, although Brazil reminds us of the title to this dispute, the title assigned by the Secretariat is of no relevance, one way or another, in determining whether Brazil's request meets the requirements of Article 6.2. In any event, when Canada sought clarification from Brazil as to the scope of its claims, Canada indeed referred to the title of this dispute and asked Brazil whether Claims 1, 5 and 7 were intended to refer to certain practices or programs only as they relate to regional aircraft. Brazil chose not to respond, leaving Canada to conclude that their Claims may not, in fact, have been limited in the manner suggested by the title.

22. Even though Brazil is not permitted to "cure" the defects in its Panel request, its subsequent submissions have in fact only added to the confusion. For example, paragraph 24 of the 22 June submission states that "Canada Account uses types of support not included in Brazil's claims, including export credits insurance, performance insurance, and political risk insurance." However, paragraph 78 of Brazil's First Submission provides in part that: "Canada Account offers…major financial services to support Canadian exporters: export credits insurance…performance insurance, and political risk insurance. These constitute either a 'direct transfer of funds' or a 'potential direct transfer of funds or liabilities,' under Article 1.1(a)(1)(i) to the SCM Agreement….All of these export credits, whatever their form, also constitute the provision of services other than general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the Agreement." Given this inconsistency, it remains entirely unclear which Canada Account "services" or "export credits" are included in Brazil's claims.

23. Paragraph 24 of Brazil's 22 June submission states that "EDC similarly provides various types of support not subject to Brazil's claims, such as accounts receivable insurance, bonding, and political risk insurance." Yet paragraph 40 of Brazil's First Submission states that "EDC offers 'a wide range of financial services' to Canadian companies. These financial services include credit

insurance, financing services, bonding services, political risk insurance and equity. They constitute financial contributions within the meaning of Article 1.1(a)(1) of the SCM Agreement." Brazil's First Submission (starting at paragraph 60) also challenges "financial services" generally, which would seem to include the financial services listed above. Given this inconsistency, it remains entirely unclear which EDC support or financial services are included in Brazil's claims.

24. Paragraph 24 of Brazil's June 22 submission similarly states that Investissement Québec "extends support not included in Brazil's claims, such as suretyship and exchange rate guarantees." However, in its argument on Investissement Québec, Brazil's First Submission states at paragraph 92 that: "[t]he provision of financial services in the form of loans and guarantees ("suretyship") constitute financial contributions within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement." Given this inconsistency, it remains entirely unclear to Canada which Investissement Québec financing or support is included in Brazil's claims.

25. More generally, when Brazil states in paragraph 24 of its 22 June submission that certain types of support are not included in its claims, it seems to provide only examples of the types of support not subject to its claims. This raises the obvious question as to what other types of activities are not subject to Brazil's claims.

26. Indeed, the failure of Brazil to abide by the requirements of DSU Article 6.2 are particularly evident when Brazil's Panel request is read with paragraph 24 of Brazil's 22 June submission. Claim 1 challenges "Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account...." However, paragraph 24 states in part that: "Canada Account uses types of support not included in Brazil's claims, including…."

27. Claim 5 challenges "Export credits, including financing, loan guarantees, or interest rate support by or through the EDC...." Paragraph 24 says that "EDC similarly provides various types of support not subject to Brazil's claims, such as…."

28. Claim 7 impugns "Export credits and guarantees provided by Investissement Québec, including....." Paragraph 24 states that Investissement Québec "also extends support not included in Brazil's claims, such as….")

29. Thus Brazil's request for a Panel used all-encompassing language, advising Canada that certain measures were challenged, "including" some examples listed by Brazil. Canada was not advised what components of the challenged measures were not so "included". In Brazil's 22 June submission, Brazil has now advised Canada that certain measures were not included, although again without specifying which ones. This falls short of the minimum standards imposed by Article 6.2.

30. Canada also agrees with the observation made in paragraph 18 of the EC third party submission that "loosely worded requests for the establishment of a panel, such as the catch-all clause 'including, but not limited to', to describe the subject matter of a dispute have...rightly been held to fall short of the minimum requirements for a request for the establishment of a panel." Brazil cannot have met the requirements of Article 6.2 of the DSU when even at this late date it has still failed to clearly specify the matters at issue

31. Brazil refers to the so-called "attendant circumstances" in this case. More specifically, Brazil argues that Canada's ability to defend itself in this case has not been prejudiced, because "Canada is very much aware of the issues and claims involved and, as such, has been and will continue to be able to vigorously defend itself." However, as a result of Brazil's failure to meet the minimum requirements of Article 6.2, Canada has suffered actual prejudice in the conduct of its defence. In *Thailand Steel*, the Panel found that the prejudice to Thailand "was a function of the fact that the precise nature and scope" of Poland's claim "remained unclear and confusing" to Thailand. The same

rationale applies equally here. Brazil's claims remain "unclear and confusing" to Canada. Moreover, given the contradictory statements cited above, they would also appear to be unclear and confusing to Brazil.

32. The deficiencies of Brazil's complaint are not mere formalities. Knowing the case to be met is essential to a Member's right to fully defend its laws and programs. Complaining Members should not be permitted to gain a litigation advantage by obscuring the target and the basis of their challenge until the filing of the first submission or later. Clarity in the framing of a complaint protects the interest of the defending Member, as well as third parties participating in the dispute and all other Members who stand to be affected by the outcome of the dispute. Article 6.2 safeguards Members' rights by ensuring that they know the case to be met.

33. Even after the filing of its first submission, the precise scope and nature of Brazil's claims 1, 2, 5 and 7 remain unclear. Canada therefore urges the Panel to find that those claims are inconsistent with Brazil's obligations and Canada's rights under Article 6.2 and therefore are not properly before this Panel.

34. In paragraph 36 of its 22 June Submission, Brazil refers to Canada's request to obtain clarifications with respect to the scope of Brazil's claims, and asserts that "the Appellate Body's statement in *Thailand – Steel* does not, as Canada implies, impose a legal obligation on Brazil to unfold all the details of its case in response to Canada's detailed 16 May request." Canada never implied that Brazil had a "legal obligation" to "unfold all the details of its case." Instead, given the vague and broadly-worded nature of Brazil's Panel request, Canada simply sought clarification as to the scope of Brazil's claims. Brazil chose not to respond substantively to Canada's letter. Consequently, Canada chose to assert its right to seek a preliminary ruling that certain of Brazil's claims are inconsistent with DSU Article 6.2.

35. In paragraph 37 of the Brazilian June 22 submission, Brazil refers to the "considerable detail" regarding its claims provided in its May 21 letter. However, that letter in no way identified the scope of Brazil's claims. On the contrary, the sweeping request in Brazil's 21 May letter implied that Brazil's claims were even broader than the Panel request suggested, in that they extended not just to current practices but to past practices as well.

36. The EC shares Canada's view on Article 6.2. Its third party submission states that "Canada's rights of defence and the third parties' ability to clearly understand the purview of the present dispute have been seriously curtailed." The EC urges the Panel to conclude that Claims 1, 2, 5 and 7 are not properly before it.

37. To conclude, Canada respectfully requests the Panel to make the rulings on jurisdiction identified in paragraph 62 of our Preliminary Submission, namely that:

> Claims 2 and 3 raise issues of compliance related to another dispute, which Brazil was required to bring under DSU Article 21.5. Accordingly, Claims 2 and 3 are outside the jurisdiction of the Panel;
>
> The reference in Claim 1 to certain export credits that "continue to be" prohibited subsidies raises compliance issues related to another dispute, and is also outside the jurisdiction of the Panel; and
>
> Claims 1, 2, 5 and 7 are inconsistent with the requirements of DSU Article 6.2, and therefore these Claims are outside the jurisdiction of the Panel.

ANNEX B-6

ORAL STATEMENT OF CANADA REGARDING SUBSTANTIVE ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

I. INTRODUCTION

1. In the Written Submission that it filed nine days ago, Canada stated that the only clear and consistent element of Brazil's complaint in this dispute has been Canada's offer of financing for the sale of regional aircraft to Air Wisconsin. In that submission, Canada nevertheless made a full response to Brazil's claims as it understood them.

2. In its statement today, Canada will not repeat all of the arguments it made in its First Submission. Instead, Canada will begin with a brief review of Brazil's claims and Canada's responses, elaborating on the issue of "benefit". Due to the lack of clarity in certain of Brazil's claims, and pending the Panel's preliminary ruling, Canada will place particular emphasis on the Air Wisconsin transaction.

3. Canada will explain why it is simply not credible that Embraer, without any support from the Brazilian government, could commit to offering financing to Air Wisconsin on the terms described in the information provided on Monday by Brazil. Canada will show that if Embraer's offer truly did not entail Brazilian government support, this would demonstrate that the OECD Arrangement cannot be used to determine what is a benefit for the purposes of Article 1 of the SCM Agreement. It would also mean that Canada's offer to Air Wisconsin does not confer a benefit.

4. If, however, the Embraer offer did entail Brazilian government support, Canada's offer simply matched Brazil's offer to Air Wisconsin. My colleague, Karl Blume, will explain why such matching is permitted under the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") and more specifically, the "safe haven" of the second paragraph of Item (k) in Annex I.

II. ARGUMENT

A. BRAZIL HAS FAILED TO MAKE OUT ITS CASE

5. In its First Submission, Canada showed that Brazil has not demonstrated that Corporate Account, Canada Account or Investissement Québec, as such, are illegal. Canada showed that Brazil has offered no basis for the Panel to revisit the findings of the *Canada – Aircraft I* panel that the Corporate Account and Canada Account are discretionary. Brazil itself confirmed by its evidence that Investissement Québec is discretionary. Canada also explained that Brazil has failed to demonstrate that in their specific application, any of these programmes are offering prohibited export subsidies.

6. In the case of the EDC Corporate Account, Canada reconfirms that, with the exception of official support transactions, Corporate Account activities are undertaken on commercial principles and using market pricing. EDC offers financing at market rates by setting the interest rate payable by the borrower to reflect risk, in accordance with market principles. Consequently, except when

providing official support, EDC does not offer terms more favourable than those available in the market. It therefore does not confer a benefit and is not a prohibited export subsidy. Brazil has not shown otherwise. Brazil has similarly failed to show that Investissement Québec's financing is offered on terms more favourable than those available in the market. Brazil has also failed to show that Investissement Québec financing is contingent upon exportation.

B. REFERENCE TO THE ARRANGEMENT DOES NOT DEMONSTRATE A BENEFIT

7. In its arguments on the Corporate Account in its First Submission, Brazil contends that terms more favourable than those in the OECD Arrangement are positive evidence of a benefit within the meaning of Article 1 of the SCM Agreement. However, there is no textual basis, outside the second paragraph of Item (k), for incorporating the terms of the Arrangement into the SCM Agreement. The reference to the OECD Arrangement is thus in the context of an exception to Article 3. No principle of logic or legal interpretation requires the incorporation of an exception as a benchmark for a definition.

8. In fact, it is particularly odd that Brazil would suggest that it can show the existence of a benefit under Article 1 of the SCM Agreement with reference to two terms of the OECD Arrangement, the 10 year repayment term and the CIRR. Just last month, at a meeting of the SCM Committee, Brazil expressed its concern that in the context of the SCM Agreement, reference to the OECD Arrangement could create what Brazil called "a permanent 'carte blanche' to the participants of that Arrangement to alter WTO rules".

9. It is one thing to allow conformity with the interest rates provisions of the Arrangement to offer a safe haven for what would otherwise be a prohibited export subsidy. The SCM Agreement expressly provides for this in Item (k) and the Members of the WTO have agreed to it. However, it is quite another to allow the Arrangement to determine what is or is not a benefit under Article 1. That would enable the participants in the Arrangement to alter WTO rules by altering the terms of the Arrangement – precisely the concern that Brazil has raised in the SCM Committee and something to which the Members of the WTO have not agreed.

10. Whether or not a benefit has been conferred must be determined not with reference to the Arrangement, but, as the Appellate Body has found, with reference to the terms that could be obtained in the market. As Canada explained in its Written Submission, the Arrangement becomes relevant only once a subsidy has been found to exist and a Member seeks to rely on the safe haven of Item (k).

11. There are no better examples of why this is the case than two of the situations before the Panel. First, Brazil has argued that EDC Corporate Account transactions confer a benefit because they are offered for repayment terms longer than the 10 year limit in the Arrangement. However, as Canada showed in its Written Submission, repayment terms of greater than 10 years for regional aircraft financing are entirely consistent with the terms that can be obtained in the market. By Brazil's reasoning, if all other terms of a transaction were equal but EDC offered financing with a repayment term of 11 years while a commercial bank offered 16 years, EDC's financing would be deemed to confer a benefit simply because it exceeded the Arrangement, even though it was significantly less favourable than the terms available in the market. The SCM Agreement simply cannot have this result.

12. The second example is the Air Wisconsin transaction itself. According to the information Brazil provided to the Panel on Monday, Embraer made two offers to Air Wisconsin, one at what Embraer calls []. At this time, Canada will not comment specifically on the first of these offers, as it was apparently superseded, except to state that to its knowledge there is no such thing as a [].

13. Brazil asks the Panel to believe that Embraer's offers involved no support from the Brazilian government. The Panel is asked to believe that the financing described in Embraer's letter was available in the commercial market to Air Wisconsin for []. However, the Arrangement imposes a maximum repayment term of 10 years and a loan-to value limit of 85 per cent, []. Thus, Embraer's claim, if accepted, confirms the illogic of Brazil's position that the Arrangement could determine what terms are "at market" for the purpose of establishing a "benefit" under Article 1 of the SCM Agreement.

C. EMBRAER'S EXPLANATION OF THE AIR WISCONSIN TRANSACTION IS NOT CREDIBLE

14. Embraer's exact statement in its letter is that: "EMBRAER made two financing offers, neither of them involving any support from the Brazilian Government." In Canada's view, this raises three possibilities:

- First, the statement may be the truth but not the whole truth. That is, at the time the offers were made, it may technically be true that the Brazilian Government had not formally committed to providing support, but the offers were made in the expectation and on the understanding that the Brazilian government or an agency of the government would provide the necessary support.

- Second the statement may be false. In order to accept the veracity of the statement, one would have to find: (a) that the Air Wisconsin official cited in Canada's Exhibit CDA-1 was lying to Bombardier when he told the Bombardier official that Embraer's offer involved BNDES and PROEX support, or that the Bombardier official was lying when he reported this back to his company; (b) that Air Wisconsin officials misrepresented the nature of Brazil's involvement when they met with Canadian officials; and (c) that Embraer realistically could have arranged commercial financing for []. Even the highest rated US airlines, such as American, are routinely required to pay interest rates significantly greater [] when financing aircraft even at loan-to-value ratios of below 70 per cent.[1] Yet Brazil would have the Panel believe that Embraer was capable of []. The claim is simply not credible.

- The third possibility is that the statement is true. That is, incredible as it might seem, Embraer discovered a source, or sources, of commercial credit that were prepared to support its offer to Air Wisconsin of [].

15. If the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms claimed by Embraer, then the financing offered by Canada - essentially a [] – would be no more favourable than Embraer's "market" terms. Air Wisconsin itself confirmed this in its letter of 20 March 2001 (filed as Canada's Exhibit CDA-2).

16. Accordingly, if the Panel determines that Embraer is telling the truth, then Canada's offer to Air Wisconsin would be on terms no more favourable than those available to the recipient in the market. One would therefore have to infer that Canada's offer does not confer a benefit within the meaning of Article 1 of the SCM Agreement.

17. If, however, the Panel considers that Embraer's offer to Air Wisconsin did involve Brazilian government support, Canada's offer was made to match Brazil's support and therefore qualifies for the "safe haven" of Item (k). I will now turn to Karl Blume, to discuss this issue.

[1] Morgan Stanley Dean Witter Report, 10 February 2001 (Exhibit CDA-14).

D. CANADA'S MATCHING OF BRAZIL'S OFFER TO AIR WISCONSIN IS PERMITTED BY THE SCM AGREEMENT

18. Brazil alleges that the Air Wisconsin transaction constitutes a prohibited export subsidy that does not qualify for the "safe haven" of the second paragraph of Item (k) to Annex I of the SCM Agreement because Canada's offer was made on a matching basis and matching is not an "interest rates provision".[2]

19. Brazil's argument is based on an *obiter dictum* by a previous panel.[3] The previous panel made its findings in the abstract without the benefit of an actual disputed transaction. The events of this case provide practical evidence of why the SCM Agreement permits matching.

20. The matching provisions of the OECD Arrangement are expressly permitted by, and conform to, the OECD Arrangement. Moreover, the matching provisions of the OECD Arrangement are "interest rates provisions" within the meaning of the second paragraph of Item (k). Accordingly, because Canada's action with respect to Air Wisconsin is on a matching basis as expressly permitted by the OECD Arrangement and as envisaged by the SCM Agreement, the transaction qualifies for the "safe haven" of the second paragraph of Item (k).

21. The second paragraph of Item (k) provides an exception to the general prohibition on export subsidies found in Article 3 of the SCM Agreement. 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 SCM Agreement.[4]

1. Matching is in Conformity with the "Interest Rates Provisions" of the Arrangement

(i) Conformity with the Arrangement

22. The *Canada – Aircraft I* Article 21.5 panel ("Article 21.5 panel") found that some matching – but not all – was, by the OECD Arrangement's own terms, not in "conformity" with the provisions of the OECD Arrangement, and thereby, not in conformity with the "interest rates provisions" of the Arrangement.[5]

23. This is contrary to the text of the second paragraph of Item (k). As the Article 21.5 panel admitted itself, matching is "permitted" by the provisions of the Arrangement.[6] Article 29 of the Arrangement specifically permits matching. Matching cannot be "permitted" by the Arrangement and at the same time not be in "conformity" with that same Arrangement.

(ii) Matching is an "Interest Rates Provision"

24. Moreover, matching is itself an "interest rates provision". The most logical interpretation of the term "interest rates provisions" includes all substantive provisions in the Arrangement that determine what interest rates are permitted, and that affect what the interest rate and the amount of interest will be, in a given transaction. Matching addresses one set of circumstances that affect the

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[2] Brazil's First Submission, at paras. 74-81.

[3] *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, adopted 4 August 2000, at paras. 5.124-5.126 [hereinafter "*Canada – Aircraft I*, Article 21.5 Panel Report"].

[4] *Id*., at para. 5.78.

[5] *Id*., at paras. 5.124 -5.126.

[6] *Id*., at paras. 5.124-5.125.

determination of interest rates and is consistent, and conforms with, the Arrangement. The US and EC both support Canada's view that matching is an "interest rates provision".[7]

25. All of the "interest rates provisions" – including matching – operate together to discipline the terms and conditions of a particular transaction in a way that minimum interest rates, on their own, could not achieve. Matching fosters compliance with the other "interest rates provisions".

(iii) Conclusion

26. The text of the second paragraph of Item (k) requires "conformity" with the "interest rates provisions" of the Arrangement.[8] As Canada has demonstrated, matching conforms to the provisions of the Arrangement by its own terms. Furthermore, matching is itself an "interest rates provision". Accordingly, matching is in "conformity" with the "interest rates provisions" of the Arrangement.

2. Members Incorporated the Discipline of Matching.

27. Not only does the text of the second paragraph of Item (k) support Canada's view that matching is in "conformity" with the "interest rates provisions" of the Arrangement, matching is consistent with the object and purpose of the SCM Agreement.

28. The intent of the SCM Agreement drafters was not that some Members must remain at a permanent disadvantage to other Members that fail to fulfil their obligations. The SCM Agreement drafters envisaged such a situation and incorporated the discipline of matching into the SCM Agreement through the second paragraph of Item (k). Incorporating the matching disciplines of the Arrangement fulfils the drafters' intent and, as Canada has demonstrated, is consistent with the text of the second paragraph of Item (k).

29. The incorporation of the "interest rates provisions" of the OECD Arrangement in the GATT Subsidies Code and in the SCM Agreement indicates that the signatories were fully aware of the object and purpose of the Arrangement and found it to be consistent with, and support, the object and purpose of the SCM Agreement. The reliance on the disciplines developed by the Participants to the Arrangement reflects the acceptance by all Members of the Participants' particular expertise in the field of officially supported export credits.

30. When Members agreed to the WTO Agreements including the SCM Agreement in 1994 , the Arrangement had been successfully disciplining trade distorting export subsidies for over 15 years. In that light, Members were almost certainly aware of the success of the Arrangement in limiting the use of trade distorting export subsidies. The Arrangement's success came through the implementation of a full set of well-balanced rights and obligations in the field of export credits. In the absence of any particular language in the second paragraph of Item (k), there is no reason to believe that Members would have wanted to discard one key instrument in this set of rights and obligations.

3. The "Interest Rates Provisions" – Including Matching – Do Not Introduce an Imbalance of Members Rights and Obligations.

31. The Article 21.5 panel stated that because the second paragraph of Item (k) creates an exemption from a prohibition in a WTO Agreement – with the scope of that exemption being in the hands of a subgroup of Members – it was important that the second paragraph of Item (k) not be

[7] See US Third Party Submission, at paras. 10-15, and E.C. Third Party Submission, at paras. 57-70.

[8] The OECD Arrangement is an "international undertaking on official export credits" in the sense of the second paragraph of Item (k). See *Canada-Aircraft I*, Article 21.5 Panel Report, at para. 5.78.

interpreted in a manner that allows that subgroup of Members to create for itself *de facto* more favourable treatment under the SCM Agreement than is available to all other Members.[9]

32. The application of all the "interest rates provisions" of the OECD Arrangement – including matching – is not *de facto* more favourable treatment for Participants to the Arrangement because it is available to all other WTO Members. In Canada's view, the right to offer terms on a matching basis is available to all Members. If the matching transaction of a non-Participant were challenged at the WTO and found to provide a prohibited export subsidy, the "safe haven" of Item (k) would be available to that non-Participant, provided that the matching was undertaken in good faith and on the basis of reasonable due diligence.

33. Furthermore, in Canada's view, the "interest rates provisions" do not include procedural requirements of the Arrangement with which a non-Participant inherently could not comply.

4. On a Systemic Level, Matching Directly Supports Real Disciplines Under the SCM Agreement.

34. The Article 21.5 panel equated matching, in some circumstances, to a derogation.[10] The text of the Arrangement does not support this view. Article 29 specifically permits matching as a response to an "initiating offer" that may or may not comply with the Arrangement. It is the initiating offer that, in some circumstances, is the derogation – never the response. The initiating offer – when it amounts to a derogation – is specifically prohibited under Article 27 of the Arrangement. The response is specifically permitted by Article 29 of the Arrangement, and qualifies for the "safe haven" by virtue of being an "interest rates provision" within the meaning of the second paragraph of Item (k).

35. Matching is an explicitly permitted response when, in certain cases, export subsidy disciplines have not been complied with. Matching does not encourage non-compliance with the disciplines. Instead, matching directly supports the disciplines of the SCM Agreement on a systemic level by providing a strong and effective disincentive to breach the disciplines. The strengthening of the export subsidy disciplines that matching provides to the Arrangement applies equally to the disciplines of the SCM Agreement because matching is an "interest rates provision" under the second paragraph of Item (k).

36. Matching is consistent with both the second paragraph of Item (k), and with the object and purpose of the SCM Agreement in disciplining trade-distorting export subsidies. Matching restores equilibrium and removes the illegal advantage of Brazil's financing package as an element – often the deciding element – in the decision of an airline of which aircraft to purchase, rather than basing the decision on the characteristics, quality and price of the aircraft itself.

5. Transparency Is Not An Advantage For Participants to the Arrangement – It Is a Competitive Disadvantage.

37. When considering the importance of transparency to the SCM Agreement, the Article 21.5 panel stated that non-Participants to the Arrangement would not, as a matter of right, have access to information regarding the terms and conditions offered or matched by Participants. Therefore, non-Participants would be at a systemic disadvantage vis-à-vis Participants.[11] A closer examination of this issue reveals no systemic disadvantage to non-Participants.

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[9] *Id*., at paras. 5.132-5.133.
[10] *Id*., at paras. 5.124-5.125.
[11] *Id*., at para. 5.134

38. Transparency among Participants does not disadvantage non-Participants. In contrast to non-Participants, Participants must provide the terms and conditions of a matching offer to other Participants. Non-Participants would not be under an obligation to provide information on matching offers to anyone. When Participants provide the terms and conditions of a matching offer to other Participants, the offer is subject to the prior scrutiny of the other Participants. The matching offer of a non-Participant would not be subject to any scrutiny under the Arrangement. Furthermore, although non-Participants would not receive the terms and conditions of Participants' matching offers, Participants would likewise not receive non-Participants' matching offers.

39. Moreover, non-Participants are advantaged because the Arrangement is a public document. By virtue of the Arrangement being a public document, non-Participants know the basic terms and conditions that Participants may offer. However, the terms of non-Participants' offers are not public knowledge.

40. Accordingly, transparency is not an advantage for Participants to the Arrangement, it is a competitive disadvantage.

III. CONCLUSION

41. Mr. Chairman, distinguished members of the Panel, there are two distinct categories of claims before you. The first category is Brazil`s Air Wisconsin claims. In considering these, you face the choice of accepting or rejecting Embraer`s assertion that its offers to Air Wisconsin did not involve government support. In Canada`s view, the assertion lacks all credibility. If you accept it, then the necessary inference is that Canada`s offer to Air Wisconsin is on terms no more favourable than those available to the recipient in the market and does not confer a benefit under Article 1 of the SCM Agreement. If you reject it, the law and the evidence support a finding that Canada`s offer was made to match Brazil`s support and qualifies for the "safe haven" of the second paragraph of Item (k).

42. The other category of Brazil's claims involves EDC's Canada and Corporate Account programmes and Investissement Québec. Brazil has failed in all cases to substantiate these claims.

43. Accordingly, Canada requests that the Panel dismiss both categories of Brazil's claims.
I thank you for your patience and attention.

ANNEX B-7

RESPONSES OF CANADA TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST MEETING OF THE PANEL

(6 July 2001)

Both parties

Question 1

What, if any, is the precedential effect of the findings of the Canada – Aircraft (DS70) panel on this Panel's consideration of Brazil's claims regarding the Canada Account and EDC programmes as such? What, if any, is the precedential effect of the findings of the Canada – Aircraft (DS70) panel on the matching provisions of the OECD Arrangement under item (k) of the Illustrative List of the SCM Agreement.

1. In *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* the panel found that panels are not legally bound by previous decisions of panels or the Appellate Body even if the subject-matter is the same, but that they should take into account the conclusions and reasoning of previous panels and the Appellate Body.[1] Canada agrees. In Canada's view, previously adopted panel reports are not legally binding precedents (*stare decisis*). However, as the Appellate Body stated in *Japan – Taxes on Alcoholic Beverages*, at page 14:

> Adopted panel reports are an important part of the GATT *aquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute. However, they are not binding, except with respect to resolving the particular dispute between the parties to that dispute.

2. The Appellate Body was referring to GATT reports, but there is no reason why the Appellate Body's finding should not apply equally to WTO reports.

3. The general practice has been for panels and the Appellate Body to follow the relevant findings of previous reports. At least one publicist, observing the Appellate Body, has characterized this as "*de facto*" *stare decisis* and has argued that the absence of *stare decisis* is a "myth".[2] However, panels have in some cases seen fit to depart from the findings of previous panels. For example, in the current Article 21.5 proceeding in *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*,[3] in response to a request by the European Communities

[1] *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, Report of the Panel, WT/DS79/R, adopted 2 September 1998, para. 7.30.

[2] R. Bhala, "The Precedent Setters: *De Facto Stare Decisis* in WTO Adjudication," (1999) 9 J. Transnat'l L. and Pol'y 1; "The Myth About *Stare Decisis* and International Trade Law," (1999) 14 Am.U. Int'l L.Rev. 845. In the latter article, the author notes that among those who have grappled with the issue of *stare decisis* in the WTO, in his view inconclusively, are the Chairman of this Panel and counsel for Brazil.

[3] WT/DS 103; WT/DS 113.

(EC), the panel made a preliminary ruling that Article 10.3 of the DSU entitles third parties to receive all submissions, including rebuttal submissions filed prior to the hearing. In reaching this conclusion, the panel departed from the approach taken by previous panels in *Australia – Automotive Leather, Australia – Salmon*, and *United States – DRAMS*. In each of those previous disputes, the panel had rejected a similar request by the EC. Similarly, in *Canada – Autos* the panel seems not to have followed the *Indonesia – Autos* panel with respect to the meaning of "unconditionally" in Article I:1 of the GATT.[4]

4. In practice, panels are likely to follow the findings of previous panels unless there is a good reason for not doing so, for example if the circumstances giving rise to the previous finding can be distinguished or if it can be shown that the previous panel was wrong.

5. In the present case, there is no good reason for this panel to diverge from the finding of the *Canada – Aircraft* (DS 70) panel that EDC's Canada Account and Corporate Account programmes involve discretionary rather than mandatory legislation and are therefore not, as such, subsidies contingent upon export performance. These programmes still involve discretionary rather than mandatory legislation. The *Canada – Aircraft* (DS 70) panel found that Brazil had failed to demonstrate otherwise. Without prejudice to Canada's answer to Question 2, in this dispute, Brazil has put forward no new arguments or evidence that would justify this Panel making a different finding.

6. By contrast, there are good reasons for this Panel not to follow the Article 21.5 panel report in *Canada – Aircraft* (DS 70) with respect to "matching". The Article 21.5 panel interpreted the whole of the matching provisions of the OECD Arrangement as not being "interest rates provisions" within the meaning of Item (k), second paragraph, of the Illustrative List. In the present case, at paragraphs 47 to 61 of its First Submission and paragraphs 18 to 40 of its First Oral Statement, Canada has put forth arguments that justify this Panel making a different and more qualified finding.

Question 2

Does this Panel have jurisdiction to review Brazil's claims regarding the Canada Account and EDC programmes as such? In particular, is the principle of res judicata, or a similar principle, applicable in this case, so as to preclude the Panel's consideration of issues previously ruled on by a panel?

1. In its Preliminary Submission, Canada argued that Brazil's claims regarding EDC's Canada Account and Corporate Account programmes "as such" fell outside the Panel's jurisdiction. However, Canada did not base its arguments on the principle of *res judicata*, i.e. the principle that the decision of a matter on the merits is conclusive as between the parties to the decision and therefore is a bar to a subsequent action by those parties on the same claim.

2. It may be that the principle of *res judicata* is a "generally recognized principle of law" within the meaning of Article 38(1) of the Statute of the International Court of Justice (ICJ).[5] If so, the principle should apply to international dispute settlement bodies except where an applicable international agreement provides otherwise. The DSU does not provide otherwise. Moreover, there are three required elements for the application of the *res judicata* principle: identity of parties, identity

[4] *Canada – Measures Affecting the Automotive Industry*, Report of the Panel, WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 10.28.

[5] *Effect of Awards of Compensation Made by the United Nations Administrative Tribunal*, 1954 I.C.J. 47, p. 53; *Request for Interpretation of the Judgment of 11 June 1998 in the case Concerning the Land and Maritime Boundary Between Cameroon and Nigeria (Cameroon v. Nigeria), Preliminary Objections*, 1999 I.C.J. 3, p. 36.

of cause and identity of object in the subsequent proceedings.[6] All three of these elements are present in this dispute with respect to Brazil's "as such" claims regarding Canada Account and Corporate Account. Thus, if the Panel considers that the principle of *res judicata* applies to WTO disputes, its application is warranted in respect of Brazil's "as such" claims regarding Canada Account and Corporate Account.

3. However, the Panel need not decide whether the principle of *res judicata* applies to WTO disputes because, as noted in Canada's answer to Question 1, Brazil has, in any event, failed to offer any evidence or arguments that would warrant this panel departing from the findings in *Canada – Aircraft* (DS 70) that Canada Account and Corporate Account involve discretionary legislation and therefore are not, as such, subsidies contingent upon export performance.

4. Canada also notes that with respect to the issue of "matching" under the OECD Arrangement, the principle of *res judicata* cannot apply because only one of the three requirements for the application of *res judicata*, the identities of the parties, is satisfied. Furthermore, the force of *res judicata* does not extend to the reasoning of a judgment.[7] Canada has argued with respect to matching that both the reasoning and the conclusion of the Article 21.5 panel in *Canada – Aircraft* (DS 70) are incorrect.

Canada

Question 3

Is it Canada's position that EDC financing under market windows is provided on terms and conditions no more favourable than could be obtained by the borrower in the commercial market-place?

1. Yes. Broadly speaking, EDC undertakes two types of financing through its Corporate Account. One type, official support transactions, has occasionally been used for regional aircraft financing. Transactions of this type have been consistent with the OECD Arrangement. The other type of Corporate Account financing is undertaken on market terms. EDC does not offer terms more favourable than those available in the market when providing such financing.

Question 4

At page 22 of its first written submission, Canada includes a description of EDC's practices. The second paragraph thereof describes EDC's pricing process. It essentially involves fixing a "benchmark" or "alternative benchmark", and pricing "according to" that "benchmark" or "alternative benchmark".

(a) Is it Canada's position that this pricing process does not result in the provision of financing on terms more favourable than could be obtained by the relevant borrower in the commercial market place?

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[6] *South West Africa (Ethiopia v. South Africa; Liberia v. South Africa)* 1966 I.C.J. 6, p. 333.

[7] *Case Concerning the Barcelona Traction, Light and Power Company, Limited, (New Application: 1962)* 1970 I.C.J. 3, p. 267; *Application For Revision and Interpretation of the Judgment of 24 February 1982 in the Case Concerning the Continental Shelf (Tunisia v. Libyan Arab Jamahiriya)* 1985 I.C.J. 192, p. 228. But see S. Rosenne, *The Law and Practice of the International Court* 1920-1996, 3rd ed., vol. III: Procedure (The Hague: Martinus Nijhoff, 1997), p. 1656 and note 206. He suggests that *res judicata* as applied by the ICJ derives from Articles 59 and 60 of the Statute of the ICJ rather than from a general principle of law that the Court would adopt by virtue of Article 38 of the Statute.

1. Yes. In establishing Corporate Account pricing for non-official support transactions, EDC fixes the benchmark for each borrower by utilizing that borrower's credit rating for a similar debt situation. If independent credit ratings are not available for the borrower from a major rating agency, EDC will generate an internal rating by using financial modeling software (FAMAS/Moody's Financial Analyst and LA Encore/Moody's Risk Advisor both now owned by Moody's Risk Management Services a subsidiary of Moody's Investor Services, one of the world's premier rating agencies). This allows the establishment of a market-based rating using historical and projected financial information.

2. Using the credit rating generated or obtained for each borrower, EDC utilizes industry sources to determine pricing for comparable credit situations as well as historical pricing for the borrower involved (including secondary market pricing). Industry sources for such pricing data include Bloomberg Fair Market Yield Curves[8], pricing offered to comparable borrowers, bond market pricing, structured transaction pricing (i.e. EETCs), as well as on-going contacts with financial institutions and financial arrangers active in the capital markets.

3. In addition, EDC can and does participate in financing arranged by commercial banks on market terms (for example, the Kendell transaction described in Canada's answer to Question 11).

(b) In fixing the "benchmark", EDC has regard to "what the relevant borrower has recently paid in the market". How does Canada define the "market"? Is it composed of commercial lenders, export credit agencies, or both?

1. The "market", as used in fixing the benchmark for a borrower is the commercial marketplace. It includes banks, other commercial financial institutions and the public bond market but does not include export credit agencies.

Question 5

For the purpose of Questions 5 - 7 only, please assume that Brazil's request for the establishment of a panel is interpreted as being limited to assistance provided to the regional aircraft industry. With respect to Brazil's request for findings that Canada Account as such, as applied and in individual transactions, constitute prohibited export subsidies, please indicate why Canada considers that Brazil's request for establishment fails to adequately identify the measure at issue. Please do the same in respect of Brazil's request for findings that EDC and IQ as such, as applied and in individual transactions also constitute prohibited export subsidies.

1. The Panel's question highlights the failure by Brazil in its panel request to adequately identify the measure at issue in respect of Canada Account, EDC (Corporate Account) and IQ as such, as applied and in individual transactions. Despite the wording of the question, in its panel request, Brazil did not request findings that Canada Account, Corporate Account and IQ "as such, as applied and in individual transactions" constitute prohibited export subsidies.

2. Brazil did not make this distinction until its 22 June Reply Submission, when Canada learned for the first time of Brazil's "overarching claim" theory. Even then, as the European Communities noted at paragraph 10 to 14 of in its Oral Statement of 27 June, it is still not clear whether Brazil is

[8] The Bloomberg Fair Market Yield Curve or Fair Market Sector Curve (FMC) is used to compare yields across maturities of multiple bond sectors and ratings. The Curve allows one to compare sector curves to benchmark curves (e.g. US Treasuries) to determine current spreads. Curves within the same sector can be compared with the benchmark as well as those with a different rating.

FMC's are created using prices from new issue calendars, trading/portfolio systems, dealers, brokers and evaluation services which are fed directly into the specified bond sector databases on an overnight basis.

challenging a programme (such as Canada Account "as such"), specific financing under a programme, (such as the Kendell transaction under Corporate Account), or all financing under those programmes, at least in respect of the Canadian regional aircraft industry. Programs "as such", "as applied" and "individual transactions" may all involve measures for the purposes of dispute settlement, but they will not be the same measures. By failing in its panel request to adequately identify the measures it is challenging, Brazil has failed to satisfy the requirements of Article 6.2 of the DSU.

3. Brazil clearly cannot use its subsequent submissions to attempt to "cure" the deficiencies of its panel request. The panel request – as presented to the DSB – must be the sole point of reference for the Panel in determining whether Brazil has met the standards of Article 6.2. Brazil did not distinguish in its panel request between claims made "as such", "as applied" and in "individual transactions". In any event, Brazil's subsequent submissions have failed to clarify the measures at issue. The EC put the matter succinctly in paragraph 12 of its 27 June Oral Statement. In assessing whether Brazil is challenging Canada Account, Corporate Account and IQ as such, as applied, or in respect of individual transactions, the EC said: "It is still not clear to the European Communities which Brazil is seeking to do."

4. Furthermore, in respect of what Brazil now seems to assert are its challenges to Canada Account, Corporate Account and IQ measures "as applied", Brazil has still failed to identify the specific measures at issue. For example, as Canada noted at the first substantive meeting, for all three programs Brazil's request used general and imprecise language ("Export credits, "including...."). By contrast, Brazil's 22 June submission apparently sought to circumscribe the scope of its claim, but only provided examples of types of measures that were not included in its claims. Brazil's 28 June statement has only added to the confusion. Many of the assertions in Brazil's 28 June statement are simply inconsistent with its Panel request.

5. Paragraph 5 of Brazil's 28 June statement asserts that: "Brazil's claims against the Canada Account are limited to 'financing, loan guarantees, or interest rate support' for the regional aircraft industry [emphasis added]." However, no such limitation is found in paragraph 1 of Brazil's panel request, which challenges "Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account...". In addition, despite the assumption on which the panel's questions 5 to 7 are based, the important qualifier "for the regional aircraft industry" is not found in paragraph 1 of Brazil's panel request.

6. Paragraph 7 of Brazil's 28 June statement says that "Brazil's claims against the EDC are limited to 'financing, loan guarantees, or interest rate support' for the regional aircraft industry." However, paragraph 5 of the Panel request refers to "Export credits, including financing, loan guarantees, or interest rate support by or though the EDC...". The qualifier "for the regional aircraft industry" is also missing in paragraph 5 of Brazil's panel request.

7. Similarly, paragraph 9 of Brazil's 28 June statement contends that "Brazil's claims against IQ are limited to "loan guarantees, equity guarantees, residual value guarantees, and 'first loss deficiencies guarantees' for the regional aircraft industry." However, paragraph 7 of Brazil's panel request challenges export credits and guarantees provided by IQ, "including loan guarantees, equity guarantees, residual value guarantees, and 'first loss deficiency guarantees'...". Paragraph 7 of Brazil's panel request also does not contain the qualifier "for the regional aircraft industry".

8. Accordingly, Brazil's panel request failed to adequately identify the specific matters at issue and therefore failed to meet the minimum standard prescribed by Article 6.2 of the DSU.

Question 6

If a measure is not identified in the request for establishment of a panel as required by Article 6.2 of the DSU, is that measure necessarily outside of the panel's terms of reference? Or does the jurisdiction of the panel over the measure also depend on whether or not the respondent has suffered prejudice as a result of the failure to identify the measure in the request for establishment.

1. If a measure is not identified in the request for establishment of a panel, as required by DSU Article 6.2, then the measure is outside the panel's terms of reference. The obligations imposed by Article 6.2 are mandatory. A panel lacks jurisdiction over the claim in respect of the measure, regardless of whether or not the respondent has suffered prejudice.

2. If the complainant has not complied with the requirements of Article 6.2, then the Panel request is invalid by the terms of Article 6.2. Such invalidity is not dependent on whether the complaining party has suffered prejudice. Even if it happens to guess correctly, a defending Member is not required to guess at what is being challenged, either with respect to what is being included in a complaint, what is being excluded from it or the legal basis of the complaint. Rather, as the Appellate Body has stated, "[a] defending party is entitled to know what case it has to answer, and what violations have been alleged so that it can begin preparing its defence".[9]

3. Article 6.2 does not impose any additional "prejudice" requirement. Nor does it create an exception from the obligations imposed if there is no "prejudice". Although, as Canada noted at paragraph 35 of its Preliminary Submission, panels and the Appellate Body have taken prejudice into account, to excuse non-compliance with the requirements of Article 6.2 on the basis that a defending Member did not suffer prejudice would create an exception to the obligations in Article 6.2. It would diminish the obligations on complainant Members, contrary to Articles 3.2 and 19.2 of the DSU. It cannot be an answer for a Member, having made an inadequate panel request, to say to the defendant in effect, "You figured it out so we didn't have to tell you".

4. In any event, Canada has suffered prejudice in the present proceedings as a result of Brazil's failure to comply with Article 6.2. As Canada noted at paragraph 61 of its Preliminary Submission, the prejudice to Canada's ability to defend itself is a function of the fact that the precise nature and scope of the claims made by Brazil are unclear and confusing. This was the test applied by the Panel in the *Thailand – Steel* dispute.[10] A party is entitled to know the case it has to answer. Even if a defending Member succeeds in deducing part, or even all, of a complaining Member's claims from an inadequate panel request, a lack of specificity regarding the measures at issue and/or a failure to provide a clear summary of the legal basis of the complaint will necessarily dissipate the efforts of the defendant, and therefore prejudice it in preparing its defence.

Question 7

With respect to Brazil's request for findings that Canada Account as such, as applied and in individual transactions constitute prohibited export subsidies, please indicate why Canada considers that Brazil's request for establishment fails to "provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly". Please do the same in respect of Brazil's request for findings that EDC and IQ as such, as applied and in individual transactions also constitute prohibited export subsidies.

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[9] *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Appellate Body, WT/DS122/AB/R, adopted 5 April 2001, para. 88.

[10] *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel H-Beams from Poland*, Report of the Panel, WT/DS122/R, adopted 5 April 2001, para. 7.29.

1. The Panel's question asks Canada to indicate why Brazil's panel request with respect to Canada Account, Corporate Account and IQ "as such, as applied and in individual transactions" fails to provide "a brief summary of the legal basis of the complaint sufficient to present the problem clearly" as required by Article 6.2 of the DSU. Again, Canada emphasizes that in its panel request, Brazil did not request findings that Canada Account, EDC (Corporate Account) or IQ constitute prohibited export subsidies "as such, as applied and in individual transactions". This failure goes to the inadequacy of Brazil's identification of the measures at issue, as described in Canada's answer to Question 5. Given this failure, it is impossible for Canada to answer the question as posed. Nevertheless, Canada will review precisely where Brazil, in its panel request, failed to satisfy this requirement of Article 6.2.

2. In its first claim, with respect to Canada Account, Brazil failed to explain what it meant when it asserted that measures "continue to be" prohibited export subsidies. As Canada noted in its Preliminary Submission, this phrase appears to be a claim that Canada has not complied with the DSB's rulings in another dispute, *Canada – Measures Affecting the Export of Civilian Aircraft* (DS70). However, this is not clear from the claim itself. The claim therefore fails to provide a summary of the legal basis of the complaint sufficient to present the problem clearly. It is therefore inconsistent with Article 6.2 of the DSU.

3. In its second claim, Brazil failed to identify the treaty provisions that Canada is alleged to have violated. As the Appellate Body stated in the *Korea – Dairy Safeguard* case, "[i]dentification of the treaty provisions claimed to have been violated by the respondent is always necessary…; such identification is a minimum prerequisite if the legal basis of the complaint is to be presented at all."[11] As the panel noted in *EC – Bed Linen*, "[f]ailure to even mention in the request for establishment the treaty Article alleged to have been violated … constitutes failure to state a claim at all."[12]

4. Both of the foregoing claims relate to Canada Account, but as noted, it is impossible to link these failures to requests for findings "as such, as applied and in individual transactions" because the claims themselves fail to do so.

5. In its fifth and seventh claims, regarding Corporate Account and IQ respectively, Brazil alleges that measures are "prohibited export subsidies within the meaning of Articles 1 and 3" of the SCM Agreement. However, only in its First Submission, filed two months later, does Brazil explain that unlike the *Canada – Aircraft* (DS 70) dispute "[t]his proceeding explicitly involves both subparagraph (i) and subparagraph (iii)" of Article 1 of the SCM Agreement."[13] Until then, Canada did not know that Brazil's claims involved subparagraph (iii) of Article 1. Canada could not tell that they did from the claims as articulated in Brazil's panel request. Furthermore, as Canada explained at the first substantive meeting of the parties, Brazil's failure to adequately identify the measures at issue in respect of these two claims made it particularly difficult to discern from the panel request the legal provisions underlying the claims. Thus, in respect of claims five and seven, Brazil failed to provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. These claims too are inconsistent with Article 6.2 of the DSU.

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[11] *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, Report of the Appellate Body, WT/DS98/AB/R, adopted 12 January 2000, para. 124.

[12] *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*, Report of the Panel, WT/DS141/R, adopted 12 March 2001, para. 6.15.

[13] Brazil's First Submission, para. 65 (in respect of Corporate Account). Similarly, at paragraph 92 of tis First Submission, Brazil asserts that its claims with respect to IQ extend to services within the meaning of Article 1.1(a)(1)(iii).

6. Again, Canada notes that while Brazil's claims five and seven relate to Corporate Account and IQ respectively, it is impossible to link the deficiencies in these claims to requests for findings "as such, as applied and in individual transactions" because the claims themselves fail to do so.

Question 8

Please provide any general or sector-specific regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of Canada Account support to the regional aircraft industry.

1. Please see exhibits CDA-15 through CDA-23 and exhibit BRA-17. With respect to exhibit CDA-15, the process for Canada Account transactions over C$50 million differs in only one respect from that for Canada Account transactions under C$50 million. Transactions over C$50 million require Cabinet approval. Transactions under C$50 million require the approval of the Minister for International Trade and the concurrence of the Minister of Finance.

Question 9

Please provide the underlying legal instruments concerning the creation and funding of Canada Account, EDC and IQ.

1. For Canada Account, please see exhibits BRA-17 and CDA-24. For EDC Corporate Account, please see exhibits CDA-24 through CDA-32 and BRA-17. For IQ, please see exhibits CDA-33 through CDA-36 and BRA-18.

Question 10

First, we note Canada's assertion that "[i]n the light of Brazil's below-market financing offer to Air Wisconsin, Canada had no choice but to offer Air Wisconsin debt financing on a matching basis" (para. 46, Canada's first written submission). Second, we note Minister Tobin's assertion that the interest rate for the Air Wisconsin transaction was "a better rate than one would normally get on a commercial lending basis". Third, we note that the Air Wisconsin transaction was financed through Canada Account, rather than EDC market windows. In light of these considerations, would Canada agree that the Canada Account financing for the Air Wisconsin transaction was below market, and therefore conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement?

1. Prior to Brazil's submission of Embraer's letter describing its financing offers to Air Wisconsin, Canada had considered that the Canada Account financing for the Air Wisconsin transaction was below market, and therefore conferred a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. However, as Canada explained at paragraphs 15 and 16 of its Oral Statement, if the Panel finds that commercial credit was available to Air Wisconsin, without Brazilian government involvement, on the terms claimed by Embraer and Brazil, those terms would be, by definition, market terms. The financing offered by Canada under the Canada Account is no more favourable than that in Embraer's offer. Accordingly, the offer under the Canada Account would be no more favourable than that available to Air Wisconsin in the market, as demonstrated by Embraer's offer, and would not confer a benefit within the meaning of Article 1 of the SCM Agreement.

2. Alternatively, if the Panel finds that Embraer's offer to Air Wisconsin did involve Brazilian government support, Canada's offer could not be said to be on market terms and would confer a "benefit". However, because the Canada Account financing is being offered on a matching basis to

Brazil's offer, it would qualify for the safe haven in the second paragraph of Item (k) to the Illustrative List and would not be a prohibited export subsidy.

Question 11

Please provide full details of the terms and conditions of the following transactions referred to at para. 43 of Brazil's first written submission:

- **the sale of [] Bombardier CRJ jets to Kendell;**
- **the sale of [] CRJ to ASA Holdings, Inc., and its subsidiary Atlantic Southeast Airlines; and**
- **the sale of [] CRJ-200 aircraft to ASA Holdings, Inc.**

Please also provide all documentation regarding the review of these transactions by the "committee" of the "EDC transportation group" referred to in the second paragraph of the description of EDC's practices set forth in para. 67 of Canada's first written submission. Please include the terms and conditions of specific transactions used to establish the committee's "benchmark" for the abovementioned transactions, or relevant details of the borrower(s) used to establish the "alternative benchmark" for the abovementioned transactions. Please also provide the credit ratings of Kendell, ASA and Atlantic Southeast Airlines at the time of the abovementioned transactions.

1. Kendell: EDC participated by way of a public offering in the initial financing of [] CRJ aircraft on an equal risk-sharing basis with five other commercial lenders: []. Terms and conditions were dictated by the arranging banks []. The financing was not conditional upon EDC's participation. Exhibits CDA-37 to CDA-41 are, respectively, Kendell's initial Executive Summary for the transaction, the Summary of Terms and Conditions of the Facility (provided by the arrangers), the Pricing Strategy submitted to the Aerospace Pricing Committee, the LA Encore ratings for the Borrower and the Kendell Term Sheet.

2. ASA: As of July 1, 2001 EDC has provided financing for the purchase of [] CRJ aircraft by ASA Inc. (inclusive of ASA Holdings, Inc. and Atlantic Southeast Airlines) and has committed financing to be completed by [] aircraft. EDC provided its commitment []. In March 1997, EDC issued a Letter of Offer for []. In August 1998, EDC issued a revised Letter of Offer for a total of [ ] aircraft (inclusive). The details of these letters, which offered pricing of UST + [], are provided as exhibits CDA-42 and CDA-43.

3. The Aerospace Pricing Committee was not established until after the issuance of both these Letters of Offer. At the time of the first Offer, LA Encore had not been developed but EDC was able to impute from Famas (commercial financial analysis software) a [] for ASA based on the company's financial results (provided as Exhibit CDA-44). Pricing was developed in consideration of the then current [], the rates paid by the airline on its other debt as well as the rate obtained by a comparable airline, [], on a recent market financing of regional jets. Then current EDC pricing offered to [] (then rated by EDC as a []) was also considered.

4. At the time of the second Offer LA Encore had been developed and a rating of "[]" was generated based on then current financial information (Exhibit CDA-45). It was determined that based on EDC's previous pricing of [], EDC's then current pricing of other like borrowers (e.g. [] which was then rated "[]" by LA Encore), the overall market conditions and the company's improved credit standing that the previous pricing was still appropriate. Although at UST + [] bps EDC's

pricing was [] bps below its [], it was deemed appropriate for the above-noted reasons and a [] was approved.

5. In addition EDC benefited from an agreement with [] which provided additional transaction support during the disbursement period for all [] aircraft such that, if [] deemed or published credit rating fell below certain benchmarks, [] would protect EDC's position.

Question 12

Please provide any general or sector-specific regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of EDC / Corporate Account support to the regional aircraft industry.

1. Please see exhibits CDA-18 through CDA-23, CDA-25 and CDA-46 through CDA 50.

Question 13

Is the description of EDC's practices set forth in para. 67 of Canada's first written submission reflected in any general or sector-specific regulations, guidelines, policies or similar documents of EDC? If so, please provide the relevant documentation.

1. The relevant documentation is the same as that listed in Canada's answer to Question 12.

Question 14

Brazil has identified a number of IQ transactions in paragraphs 90 and 91 of its first written submission. Canada has not denied that IQ was involved in any of these transactions. Please provide full details of the terms and conditions of these transactions. Please also provide all documentation regarding the review of these transactions by IQ. Please also provide the credit ratings of the relevant airlines at the time of these transactions.

1. IQ has been involved with only two of the Bombardier customers identified by Brazil, MESA and Midway. MESA's Standard & Poors credit rating was B at the time of the guarantee was approved. Midway had no public credit rating at the time the guarantee was approved, as it was then a private company.

2. IQ was also involved in three other transactions, i.e., Air Littoral, Atlantic Coast Airlines and Air Nostrum.

3. For each of these Bombardier customers, IQ provided an "equity guarantee" of up to a maximum of [] per cent of the aircraft purchase price, and in the case of Mesa, a [] per cent loan guarantee was also provided. IQ support in these transactions was limited to a total of [] aircraft deliveries, as follows:

MESA

- [] CRJ 200 aircraft on a total of [] ordered.
- Date of transaction: September 1998 and December 1999.
- Term: [] years.

Midway

- [] CRJ 200 aircraft on a total of [] ordered.
- Date of transaction: July 1998.
- Term: [] years.

Air Littoral

- [] CRJ 100/200 aircraft on a total of [] ordered.
- Date of transaction: August 1997.
- Term: [] years.

Atlantic Coast Airlines

- [] CRJ 200 aircraft on a total of [] ordered.
- Date of transaction: May 1997.
- Term: [] years.

Air Nostrum

- [] CRJ 200 aircraft on a total of [] ordered.
- Date of transaction: January 1999.
- Term: [] years.

Canada also notes that:

(a) Equity Guarantees are often provided in regional aircraft transactions.

4. IQ is not alone in providing such guarantees. In the aerospace industry, Bombardier has informed Canada that in the aerospace industry such private sector commercial actors as GE, Rolls-Royce, and Pratt & Whitney have been known to provide such guarantees. For example, as discussed in paragraph 89 of Canada's first written submission, it is Canada's understanding that Embraer aircraft purchases have been financed in part through Rolls-Royce equity guarantees.

(b) Investissement Quebec's risk is substantially mitigated [].

5. On a commercial basis, []. In this way, Quebec's risk is substantially less [].

6. To illustrate, assume for example, there were [].

(c) As is the case of private sector transactions, Quebec receives both an up-front and an on-going fee for its participation.

7. In exchange for its guarantee, Quebec receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure.

(d) The Investissement Quebec equity guarantee is used only by a small proportion of Bombardiers customers.

8. Based on order intake data for the period 1 January 1995 through 1 June 2001 inclusive, IQ guarantees were only present for [] per cent of Bombardier regional aircraft.

(e) Of those customers who have used the IQ guarantee, each has elected to use it on only some, not all of their delivered aircraft.

9. No Bombardier customer has ever made a regional aircraft purchase contingent on the presence of an IQ guarantee. Indeed, as can be seen in the above transactions, on average, Bombardier customers using IQ equity guarantees have chosen to do so on less than [] per cent of their unit volume.

Question 15

Please describe the decision-making procedures regarding the provision of IQ support to the regional aircraft industry.

1. An analysis of a proposed transaction is made by the Canadair Québec Capital (CQC) Credit Committee. The Committee is composed of three members representing [];

2. In the event of a positive credit analysis, a recommendation is made by the Credit Committee to the CQC board of directors, which reviews it and may or may not decide to accept it;

3. In the event of a positive decision by the CQC board, the proposed transaction is taken to the IQ board of directors for review and approval.

Question 16

Please provide full details of the terms and conditions of the transactions accounting for the (approx.) $300 million of IQ funding referred to in the press article cited in paragraph 85 of Brazil's first written submission.

1. Please see the answer to Question 14.

Question 17

Please provide any general or sector-specific regulations, guidelines, policies or similar documents applicable to the decision to approve specific transactions and/or concerning the fixing of the terms and conditions of IQ support to the regional aircraft industry.

1. Please see the criteria provided as Exhibit CDA-51. These criteria are used by the Credit Committee in arriving at its recommendations.

Question 18

Since the establishment of IQ, what proportion of total IQ support has directly or indirectly concerned Bombardier regional aircraft.

1. Since its establishment, 6.3 per cent of total IQ support has directly or indirectly concerned Bombardier regional aircraft.

Question 19

Since the establishment of IQ, what proportion of IQ support for Bombardier's regional aircraft products has involved the export of regional aircraft outside of Canada?

1. All of the 6.3 per cent has involved the export of regional aircraft outside of Canada.

Question 20

Since 1 January 1995, what proportion of Bombardier's regional aircraft production was exported outside of Canada?

1. From 1 January 1995 to 31 May 2001, Bombardier delivered 96.4 per cent of its regional aircraft, including jets and turboprops, to customers based outside of Canada. Bombardier has not yet compiled its deliveries for June 2001, but confirms that they will not materially change the percentage cited above.

Question 21

Since the establishment of IQ, what proportion of total IQ support has involved the export of goods / services outside of Canada?

1. Since the establishment of IQ, 23.41 per cent of IQ support has involved the "export" of goods and services outside of Québec, including to other parts of Canada. IQ does not distinguish between "exports" within Canada and those outside of Canada. Accordingly, the percentage of IQ support involving exports outside of Canada will not be greater than 23.41 per cent of total IQ support, and most likely will be lower, but it is not possible from the available data to determine the precise proportion.

Question 22

Please provide a copy of Canada's notification to the OECD regarding its decision to match EMBRAER's offer to Air Wisconsin. Please demonstrate how Canada complied with the requirements of the OECD Arrangement regarding matching in respect of the Air Wisconsin transaction.

1. A copy of Canada's notification is provided as Exhibit CDA-52.[14]

2. Article 53 of the Arrangement requires Participants that intend to match terms and conditions offered by a non-Participant to make "every effort to verify that these terms and conditions are officially supported" and to inform other Participants of the nature and outcome of these efforts. The Arrangement also requires that Participants notify all other Participants of the terms and conditions they intend to support at least 10 calendar days before issuing a commitment on such terms. If any other Participant requests a discussion during this period, the notifying Participant must wait an additional 10 days before issuing its commitment.

3. Government of Canada officials met with officials from Air Wisconsin and United Airlines on 19 December 2000 in Ottawa. The Government officials posed a variety of questions to Air Wisconsin. From the responses of Air Wisconsin, Canada concluded that the Embraer offer involved Brazilian government export financing support with []. The Brazilian government export financing programs that were discussed were BNDES and PROEX.

4. Air Wisconsin's responses also corroborated previous statements by Brazilian officials, including Brazil's then Minister of Foreign Affairs, Luis Felipe Lampreia, who stated that: "[f]or us,

[14] See Exhibit CDA-52. The contract value and credit value, i.e., items 7(a) and (b), have been redacted from the Arrangement Notification. These values are commercially sensitive as they would enable the average aircraft price to be computed. Moreover, it is Canada's view that this information is not relevant to the Panel's question.

the interest rate is the OECD rate, the coverage is 100% and there are no limits on the length of terms".[15]

5. Canada notified other Participants of its intention to match Brazil's offer on 12 January 2001. In the notification, Canada informed the other Participants of its knowledge of the Brazilian offer. No Participant requested a discussion during the 10 day waiting period. The Ministerial Authorization for EDC to commit Canada Account funding as required under Section 23(1) of the Export Development Act was issued on 25 April 2001. EDC issued a letter of offer to Air Wisconsin on 10 May 2001.

Question 23

Since 1 January 1995, how many transactions involving the sale of Bombardier regional aircraft have been financed in the commercial market, i.e., without any form of Canada Account, EDC, or IQ assistance, or without any other form of governmental assistance?

1. From 1 January 1995 to 31 May 2001, in unit terms, [] per cent of Bombardier's order book was financed in the commercial market.

Question 24

Concerning paragraph 75 of Canada's first written submission, please specify precisely how, and on what grounds, Exhibit CDA-12 demonstrates that standard commercially available financing terms for regional aircraft sales range from 10 to 18 years. In this regard, we note that page 21 of Exhibit CDA-12 refers to different types of financing sources ("private, EETC, ECA"), including governmental. Please explain who made the presentation in that Exhibit, and for what purpose. Please also explain what the Aircraft Finance and Commercial Aviation Forum is.

1. Exhibit CDA-12 is the summary of a presentation made by [] to the Aircraft Finance and Commercial Aviation Forum that was held in Geneva in February 2001.

2. [] is a leading, global source of financing and leasing capital for many industries, including commercial aviation. [] offers customized leasing and financing packages for new and used aircraft, with an emphasis on regional aircraft. [] has developed transactions involving US$ 7.6 billion of financing for regional aircraft. [] also provides bridge financing, long-term debt financing and financial advisory services worldwide. Its credentials are published on its website: []

3. The Aircraft Finance and Commercial Aviation Forum is an annual aircraft finance conference taking place in Geneva. It is internationally recognized as the leading conference on aircraft finance and commercial aviation and is a meeting place for all key players in the industry. This years' event was the 15th annual Geneva Forum. It featured 90 speakers and panelists addressing such topics as the fundamentals of aircraft finance and the latest developments in aircraft financing sources, structures and products.

4. The [] presentation was prepared for the Forum and was presented by the Managing Director of the Aerospace Group []. Given []'s in-depth knowledge of regional aircraft financing and its involvement in structuring leasing and financing packages in the commercial market for regional aircraft transactions, Canada considers that the statement in the presentation that regional aircraft financing terms range from 10 to 18 years reflects commercial realities and demonstrates that marketplace financing for regional aircraft exceeds 10 years. Canada also notes that Brazil has not

[15] See Exhibit CDA-6.

disputed Canada's position that standard commercially available financing terms for regional aircraft range from 10 to 18 years.

ANNEX B-8

SECOND WRITTEN SUBMISSION OF CANADA

(13 July 2001)

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I. INTRODUCTION

1. In this Rebuttal Submission, Canada will show, again, that despite the breadth of its challenge and its assertions, Brazil has failed to present a *prima facie* case that any of the Canada Account, Corporate Account[1] or Investissement Québec ("IQ") programmes, "as such", "as applied" or in respect of "specific transactions" are inconsistent with Canada's obligations under the SCM Agreement.

2. Canada will show that:

- There is no basis for this Panel to reverse the findings in *Canada – Aircraft I* [2] that EDC (Corporate Account) and Canada Account are discretionary;
- IQ is not "as such" inconsistent with the SCM Agreement;
- Brazil's "as such" claims would improperly condemn all ECAs, and are at odds with the facts and the law;
- Brazil seeks to make an untenable distinction between its challenges to measures "as applied" and in respect of "specific transactions"; an
- Brazil has failed to show that any specific transactions, under Corporate Account, IQ or Canada Account, including Air Wisconsin, are inconsistent with Canada's obligations under the SCM Agreement, because they are not inconsistent.

II. ARGUMENT

A. BRAZIL'S GENERIC CLAIMS ARE WITHOUT MERIT

1. Brazil's "as such" claims are groundless

3. As Canada has noted, there is no basis for finding EDC (Corporate Account) or Canada Account or IQ "as such" inconsistent with the SCM Agreement. Under well-established WTO jurisprudence, a measure can be found "as such" inconsistent with a Party's obligations only if the measure mandates a violation of the Member's obligations in some or all feasible circumstances. [3] None of the challenged programmes require financing to be provided in a manner inconsistent with Canada's obligations. Accordingly, even if Brazil's "as such" claims were properly before this panel, there is no legal or factual basis for upholding such a claim.

4. In its responses to the Panel's Question 2 concerning Brazil's claims regarding the Canada Account and EDC (Corporate Account) programmes "as such", Brazil asserts, first, that the *Canada – Aircraft I* panel did not find that these programmes were discretionary but rather, that Brazil had not

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[1] Brazil has chosen to refer to what seems to be EDC's Corporate Account as "EDC". Canada asks Brazil to clarify if, by "EDC", it is referring to anything other than Corporate Account.

[2] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, and Report of the Appellate Body, adopted 20 August 1999 [hereinafter "*Canada – Aircraft I*, Panel Report" and *Canada – Aircraft I*, Appellate Body Report"].

[3] See, e.g., *United States – Anti-Dumping Act of 1916*, Report of the Appellate Body, WT/DS136/AB/R, WT/DS162/AB/R, adopted 26 September 2000, paras. 60 and 88 [hereinafter "*United States – Anti-Dumping Act of 1916*, Appellate Body Report"].

proved that they were mandatory; and second, that Brazil has offered new evidence and arguments in this case.[4] Both assertions are unsustainable.

(a) The *Canada – Aircraft I* panel clearly found fhat EDC and Canada Account are discretionary

5. In respect of the EDC, the *Canada – Aircraft I* panel stated, at paragraph 9.129 of its Report:

> [W]e find that Brazil has failed to demonstrate that the EDC programme as such mandates the grant of subsidies. *Rather, the EDC programme constitutes discretionary legislation.* [italics added]

6. Contrary to Brazil's assertion, the *Canada – Aircraft I* panel clearly found that the EDC programme is discretionary.

7. In respect of the Canada Account, the *Canada – Aircraft I* panel stated, at paragraph 9.213 of its Report:

> [W]e find that Brazil has failed to demonstrate that the Canada Account programme as such mandates subsidies that are contingent upon export performance. *Rather, the Canada Account programme constitutes discretionary legislation*. [italics added]

8. Contrary to Brazil's assertion, the *Canada – Aircraft I* panel clearly found that the Canada Account programme is discretionary.

9. There is no reason for this panel to diverge from the findings of the *Canada – Aircraft I* panel that EDC (Corporate Account) and Canada Account are discretionary. Brazil has not submitted arguments or evidence showing that the *Canada – Aircraft I* panel erred in its findings. Nor has Brazil offered any basis on which the circumstances giving rise to the *Canada – Aircraft I* findings can be distinguished from those in this dispute.

10. Brazil also contends that Canada's refusal to provide the *Canada – Aircraft I* panel with certain information regarding specific EDC transactions might have affected the "as such" findings of that panel. However, as Brazil acknowledges, this information was in respect of specific transactions. In fact, as the Report of the Appellate Body makes clear at paragraph 205, the information at issue concerned a single transaction, involving one airline, ASA.[5] It could not possibly have affected the *Canada – Aircraft I* panel's "as such" findings.

11. Furthermore, in respect of this information, the Appellate Body indicated that Brazil was not precluded from pursuing another dispute settlement complaint against Canada "concerning the consistency of *certain of the EDC's financing measures*" with the provisions of the SCM Agreement.[6] "Certain of the EDC's financing measures" did not mean the EDC programme "as such". Nor could it possibly have meant Canada Account "as such". Brazil therefore misrepresents the Appellate Body's Report when it states that "Brazil, in this case, is following the advice of the Appellate Body."

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[4] *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, Responses of Brazil to Questions from the Panel, 6 July 2001 [hereinafter "Brazil's Response"].

[5] *Canada – Measures Affecting the Export of Civilian Aircraft*, Appellate Body Report,, para. 205.

[6] *Id*., para. 206.

(b) Brazil's "new information and evidence" is non-existent

12. In its previous submissions, Canada has shown that Brazil, not surprisingly, has offered no new evidence or information to support its allegations that Canada Account or Corporate Account are "as such" inconsistent with the SCM Agreement.[7] Brazil still has not done so because no aspect of these programmes mandates a violation of the SCM Agreement.

13. In its response to Question 2, Brazil does not identify the alleged new evidence it has provided. Nor does it actually assert that this "evidence" demonstrates that Corporate Account or Canada Account mandate the use of prohibited export subsidies. Instead, Brazil asserts, without foundation that the "evidence" shows that the "*modus operandi*" or "the very existence" of the programmes is to provide export subsidies. This does not amount to a demonstration that the programmes require the granting of prohibited export subsidies.[8]

14. In respect of the Corporate Account, the *Canada – Aircraft I* panel found that: "Brazil has failed to demonstrate that the EDC programme as such mandates the grant of *subsidies*."[9] [emphasis added] Thus, by failing to adduce new evidence, Brazil not only has failed to show that the Corporate Account programme mandates the use of prohibited export subsidies, it also has failed to show that it mandates the use of subsidies at all. It has still failed to show this, because Corporate Account financing does not mandate the use of subsidies.

15. Brazil has also failed to demonstrate that Canada Account financing mandates the granting of prohibited export subsidies. Brazil's new evidence in respect of the operation of Canada Account relates solely to the Air Wisconsin transaction. Canada's offer of Canada Account support on a matching basis in response to Brazilian government support for Embraer's offer to Air Wisconsin is not a prohibited export subsidy in accordance with Item (k) second paragraph of Annex I to the SCM Agreement.

16. Canada is also entitled to offer financing on terms no more favourable than those that would be available to the recipient in the marketplace, because such financing does not confer a benefit within the meaning of Article 1 of the SCM Agreement. At the first meeting of the parties, Brazil appeared to be contending, based on the Embraer letter it submitted,[10] that Embraer's offers to Air Wisconsin involved only commercial financing and not Brazilian government support. If so, Embraer's offer would necessarily define the terms available to Air Wisconsin in the market. So long as Air Wisconsin will not receive financing from Canada Account on terms more favourable than those offered by Embraer – and it will not – the Canada Account offer does not confer a benefit and therefore is not a subsidy.

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[7] First Submission of Canada, 18 June 2001, paras. 33 and 36 [hereinafter "Canada's First Submission"] and Canada's Answers to the Panel's Questions, 6 July 2001, Answer to Question 1, para. 5; Answer to Question 2, para. 3.

[8] In its response to the Panel's Question 2, Brazil also misrepresents Canada's position with respect to the Air Wisconsin transaction and the operation of Canada Account and Corporate Account. Brazil also seeks again to confuse the fact that the Air Wisconsin transaction involves Canada Account and not Corporate Account. In this submission, Canada's position with respect to the Air Wisconsin transaction is set out beginning at paragraph 69.

[9] *Canada – Aircraft I*, Panel Report, para. 9.129.

[10] Letter from Paulo César de Souza e Silva, Sales Financing Director, Embraer, to Roberto Azevêdo, Counsellor, Permanent Mission of Brazil, Geneva, dated 25 June 2001, faxed to the Panel on 25 June 2001.

(c) Brazil misstates the "as such" test

17. In seeking to evade the *Canada – Aircraft I* panel's findings that neither the Canada Account nor the EDC (Corporate Account) programmes are "as such" inconsistent with the SCM Agreement, Brazil in its response to Question 26, misstates what is meant by a measure being "as such" inconsistent with a Member's obligations.

18. Brazil asserts that a measure is "as such" inconsistent with a Member's obligations "when it calls for action by the executive authority that is inconsistent with a Member's WTO obligations." Brazil cites paragraph 6.13 of the GATT panel report in *United States – Non-Rubber Footwear from Brazil*[11] for this proposition. In fact, paragraph 6.13 of that Report actually states:

> The Panel noted that the CONTRACTING PARTIES had decided in previous cases that legislation manditorily requiring the executive authority to impose a measure inconsistent with the General Agreement was inconsistent with that Agreement as such … .

19. The test the *Non-Rubber Footwear* panel described was the test the *Canada – Aircraft I* panel applied in finding that the Canada Account and EDC (Corporate Account) are not "as such" inconsistent with the SCM Agreement.

20. Contrary to Brazil's argument in response to Question 26, a Member cannot look to individual transactions to "illustrate and prove that a measure is inconsistent 'as such'." To prove that a programme is inconsistent "as such", a Member must prove that the executive is legally required to act in a manner inconsistent with the WTO Agreement in some circumstances. A programme is not "as such" inconsistent with WTO rules merely because it could be applied inconsistently with a Member's obligations in some or all circumstances. Nor does the fact that a measure has been applied inconsistently make it "as such" inconsistent with WTO rules.[12] Thus, the cases have distinguished between measures that require (mandate) WTO inconsistent actions and those that grant the discretion to take such action.[13]

21. Brazil's proposition that, in the absence of evidence that inconsistent action is required, a Member can look to individual transactions to make its case is both at odds with the established test and fallacious. Brazil cannot escape the fact that nothing in the programmes it has challenged mandates the granting of prohibited export subsidies.

(d) IQ is not "as such" inconsistent and Brazil has failed to show that it is

22. As Canada has described, sections 25 and 34 of the IQ Act[14] clearly demonstrate that IQ's authority is not limited to export financing.[15] Its authority is very broad, as is its discretion in how to fulfil it. Like Canada Account and Corporate Account, nothing in the IQ Act requires the granting of prohibited export subsidies. IQ therefore cannot be inconsistent "as such" with the SCM Agreement.

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[11] *United States – Denial of Most-Favoured Nation Treatment as to Non-Rubber Footwear from Brazil*, Report by the Panel, adopted 19 June 1992, BISD 39S/128.

[12] *European Economic Community – Regulation on Imports of Parts and Components*, Report by the Panel, adopted 16 May 1990, BISD 37S/132, para. 5.25.

[13] See *United States – Anti-Dumping Act of 1916*, Appellate Body Report, paras. 60 and 88.

[14] *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 28. (Exhibit BRA-18)

[15] Canada's First Submission, paras. 38-42.

23. IQ's authority to participate in regional aircraft transactions is derived from section 28 of the IQ Act. Section 28 (formerly section 7 of the *Société de développement industriel du Québec Act*[16]) reads as follows:

> The Government may, where a project is of major economic significance for Québec, mandate the agency to grant and administer the assistance determined by the Government to facilitate the realization of the project. *The mandate may authorize the agency to fix the terms and conditions of the assistance.* [emphasis added]

24. The wording of section 28 shows that the executive authority enjoys complete discretion regarding the terms and conditions of the assistance it provides. Section 28 does not mandate the granting of subsidies contingent upon exportation. In fact, section 28 does not relate specifically to export assistance at all. It is used mostly for projects that have no export component whatsoever as well as for projects involving exports.

25. IQ's involvement in regional aircraft transactions is authorized more specifically under Decrees 792-96 (26 June 26 1996); 879-97 (2 July 1997); 1187-98 (16 September 1998); and 1488-2000 (20 December 2000).[17] These decrees simply empower IQ (and formerly the SDI) to grant guarantees or counter-guarantees up to certain amounts of money. Under these decrees, IQ enjoys complete discretion. Nothing in these decrees *mandates* the granting of prohibited export subsidies.

26. Nor does IQ provide prohibited export subsidies when it grants guarantees or counter-guarantees as it is empowered to do by the decrees because these guarantees and counter-guarantees are always provided on market terms.

27. Contrary to Brazil's assertion in the last paragraph of its response to the Panel's Question 29, nothing in the IQ programme "calls for" the provision of loan and equity guarantees. Nor does Brazil, in its response, identify the element of the IQ programme that allegedly does "call for" such guarantees. Finally, Brazil has not established that, "as such", loan or equity guarantees provided by IQ confer a benefit or are contingent upon export performance.

28. The IQ programme allows for the provision of guarantees but it does not require them. Any guarantees provided by IQ result from the exercise of its discretionary powers. Accordingly, the IQ programme could not be inconsistent "as such" with the SCM Agreement even if Brazil had established that, "as such", loan or equity guarantees provided by IQ confer a benefit and are contingent upon export performance.

29. Far from requiring the providing of a prohibited subsidy, the step-by-step description of the decision-making process for the provision of IQ financing assistance to the regional aircraft industry (set out in Canada's answer to the Panel's Question 15) shows that there are three levels of discretion when deciding whether or not to provide support.

(i) IQ does not provide a "benefit"

30. Furthermore, the criteria set out in Exhibit CDA-51 demonstrate that IQ must provide its financing assistance on market terms. The criteria provide that:

> Le support de la Société ne sera pas disponible pour des transactions:

[16] R.S.Q., c. S-11.01.
[17] Filed as Exhibits CDA-33 – CDA-36.

A. sauf si la compagnie aérienne (ou l'acheteur), sur la base d'état financiers couvrant une période minimale de deux années consécutives précédant le financement et des projections pour au moins la prochaine année:

(i) a une valeur nette tangible positive;

(ii) a un mouvement de trésorerie positif; et

(iii) est, ou est affiliée avec, (par voie de "code sharing", contrat d'affrètement, etc.) une compagnie aérienne.

B. si la rémunération que la Société est appelée à recevoir est inférieure à ce qui est offert sur le marché pour une structure et un risque similaire, pour une transaction entre participants non reliés ("arm's length") et ce, en tenant compte de la nature compétitive des transactions.

C. si le financement est d'une durée supérieure à ce qui est disponible pour un financement sans support gouvernemental pour une transaction de même nature (RJ, "arm's length", crédit, type de financement, juridiction, etc.), et ce, en tenant compte de la nature compétitive des transactions.

31. Consequently, IQ "as such" cannot mandate the provision of an export subsidy.

32. Furthermore, IQ "as such" does not mandate the provision of prohibited export subsidies because the fees it charges in order to provide support to the regional aircraft industry are at market. As the criteria set out above state, IQ will not make support available for transactions if the remuneration it is to receive is less than that offered in the market. Thus, Brazil cannot meet its burden of showing that IQ "as such" confers a benefit.

(ii) IQ is not "as such" contingent upon exportation

33. In its Oral Statement of 27 June 2001, at paragraphs 56 to 62, Brazil appears to argue that IQ is, or possibly IQ guarantees are, "as such" contingent upon exportation even though much of IQ's assistance involves the sale of goods and services within Canada. Canada elaborated, in its answer to the Panel's Question 21, that only 23.41 per cent of IQ support has involved sales of goods and services outside of Québec, including to other parts of Canada.

34. Faced with facts that make clear that IQ cannot "as such" be contingent upon exportation, Brazil argues in its oral statement that these inconvenient facts are somehow subversive of the export subsidy disciplines of the SCM Agreement. It asks: "may Canada convert a subsidy, otherwise contingent upon export, into a non-export contingent subsidy by making part, but not all, of its territory eligible for sales of the subsidized product?"

35. First, Brazil appears to be relying for its argument on Decree 572-2000, which defines "export" as being "outside of Québec". As Canada explained at paragraph 93 of its First Submission, this decree has nothing to do with aircraft sales financing. Nor does it preclude funding for projects within Québec. On the contrary, Decree 572-2000 relates to the (FAIRE) programme, the Private Investment and Job Creation Promotion Fund ("Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi"). Almost all of the financing provided under this programme is for projects within Québec.[18]

[18] Paragraphs 71 and 72 of Brazil's Oral Statement, which suggest a contradiction in Canada's position, also rest on a confusion of different programmes. The "export development" eligibility criterion of SDI to

36. Second, neither Canada nor Québec "converted" anything "otherwise contingent upon export into a non-export contingent subsidy". Most of IQ's funding does not leave Québec, let alone Canada. That this does not involve exportation, and that IQ funding is not export contingent, is not due to a "conversion" of anything. It is due to the fact that "exportation" within the meaning of the SCM Agreement refers to the movement of goods and services between Members, not within them.

(e) Brazil's "as such" claims seek falsely to condemn all ECAs

37. In its response to Questions 28 and 29 from the Panel, Brazil attempts to deal with its complete lack of new evidence that would refute the *Canada – Aircraft I* panel's conclusion that Canada Account and EDC (Corporate Account) are discretionary, or that would refute the evidence that IQ is discretionary.[19] It does so by making the extraordinary argument that *all* export credit agencies (ECAs) necessarily provide prohibited export subsidies. Brazil, by its argument, seeks to escape its burden of proving the existence of a subsidy and in particular, a benefit. Brazil's argument is not supported by the text of the SCM Agreement, and it is contrary to what previous panels and the Appellate Body have found to constitute a "subsidy".

(i) Brazil seeks to escape its burden of proving a "benefit"

38. The "substantive context" of ECAs is not, as Brazil would have it, that they "exist to subsidize exports." ECAs vary with respect to legal status, policies and products. ECAs generally exist to facilitate exports by providing financial and risk management products. They do not necessarily subsidize exports. The test of whether an ECA offers a subsidy is not "is it an ECA?". The test is whether the recipient of the financing receives a financial contribution on terms more favourable than those available to the recipient in the market.[20]

39. In certain cases, officially supported export credits may confer a subsidy. They may, for example, be used to provide or insure credits in insolvent markets and absorb risks that "'no banker in his right mind' is willing to assume." However, Exhibit BRA-54, from which Brazil extracted this quotation, states that this is "an extreme case". It does not mean that EDC or any other ECA will necessarily offer subsidies.

40. Brazil can hardly contend, for example, that EDC's participation in the Kendell transaction involved assuming risks that "no banker in his right mind" was willing to assume. As Canada described in its answer to Question 11 from the Panel, EDC participated in the Kendell transaction, a public offering, on an equal risk-sharing basis with seven commercial banks. The terms and conditions of the transaction were dictated by the arranging banks, []. The other banks were [ ]. Evidently, all seven of those banks were quite willing to assume the same risk as EDC.

41. Similarly, in paragraphs 23, 24, 54 and 68 of its 27 June 2001 Oral Statement, and again in its response to the Panel's Question 29, Brazil argues that whenever EDC or IQ provides a loan or equity guarantee, they automatically provide a benefit because their credit rating is invariably higher than that of a recipient of the financing. According to Brazil, any guarantee or counter-guarantee provided by a government credit agency automatically will be a subsidy because, given the high credit ratings of governments, they will automatically confer a benefit.

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which Brazil refers was contained in the "Programme de développement des exportations". No guarantees or financing were provided to the civil aircraft sector under that programme. Financing support for the transaction to which Brazil refers in paragraph 71 was provided under section 7 of the SDI Act (which has become section 28 of the IQ Act) [see Exhibit BRA-18], and not under the Programme de développement des exportations.

[19] Canada's First Submission, paras. 39-42.

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

42. Brazil has not demonstrated this argument. To accept Brazil's argument is to suggest that any guarantor with a higher credit rating than the recipient of the financing would automatically be providing a subsidy. Brazil's argument is also puzzling given the statement on the website of BNDES, the Brazilian government's development bank, that: "In order to make possible the export of Brazilian products, BNDES-*exim* operates with the same guarantee instruments offered by the largest export credit agencies."[21]

(ii) Brazil's argument is not supported by the text of the SCM Agreement

43. Article 1.1 of the SCM Agreement provides:

> For the purpose of this Agreement, a subsidy shall be deemed to exist if:
>
> (a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:
>
> (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees);
>
> (…)
>
> and
>
> (b) a benefit is thereby conferred.

44. If Brazil were correct that the provision by a government of a guarantee or a counter-guarantee automatically entails a benefit and therefore is a subsidy, it would render redundant paragraph (b) of Article 1.1. As a "financial contribution" as understood in Article 1.1(a)(1)(i) is always provided by a government or public body, there could not be a financial contribution in the form of a guarantee without conferring a benefit, and therefore a subsidy. However, the two-part test in Article 1.1 necessarily implies that a government or public body can provide a financial contribution in the form of a guarantee without conferring a benefit and therefore without granting a subsidy.

(iii) Brazil's argument ignores the Appellate Body's findings as to when a "subsidy" exists

45. According to the Appellate Body, the existence of a subsidy requires a financial contribution and a benefit. The existence of a benefit can be determined by whether a financial contribution was granted to the recipient on terms more favourable than the recipient could receive in the market.[22] The focus, in determining the existence of a "benefit", is on whether the recipient received terms more favourable than those available in the market. It is not on the identity of the provider of the financial contribution, which, by definition, is always a government or a public body.

46. The fact that panels and the Appellate Body have sought to determine whether or not financial contributions by a government or public body was made on market terms necessarily implies that such financial contributions can be provided on market terms and do not in and of themselves confer a benefit.

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[21] "BNDES-*exim*. Your access to global markets," http://www.bndes.gov.br/english/exim.htm, p. 2. (Exhibit CDA-53)

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

47. Thus, contrary to Brazil's assertion in response to Question 29 that Canada somehow bears the burden of showing that its programmes fall within the scope of the Item (k) exception, the burden of proof lies with Brazil to show that Canada's programmes make mandatory, action inconsistent with its WTO obligations in any circumstances. Brazil has failed to meet this burden. It cannot meet this burden because none of Corporate Account, Canada Account or IQ require Canada to provide prohibited export subsidies.

2. Brazil's claims fail to satisfy the "as applied" test

48. In addressing Question 25 from the Panel, Brazil states that it is challenging Canada's programmes, "as such", "as applied" and in respect of specific transactions. In taking this position, Brazil seems to be distinguishing between a challenge "as applied" and a challenge "in respect of specific transactions". In Canada's view, a challenge "as applied" is the same thing as a challenge to "specific transactions". Each refers to a challenge to a specific application of a measure.

(a) Brazil's distinction between "as applied" and "specific transactions" is untenable

49. If Brazil's implicit position is accepted, and a challenge to a measure "as applied" is to be distinguished from a challenge to "specific transactions", then the basis of the "as applied" challenge must be that the programme is applied such that all transactions, not just those specified, are inconsistent with the Member's obligations. Furthermore, if Brazil's "as applied" challenge is to be distinguished from an "as such" challenge, the basis of the "as applied" challenge must be that even if there is no legal requirement that transactions under a programme must be inconsistent the programme is applied such that all transactions are inconsistent. In Canada's view, there is no legal basis for such a characterization of an "as applied" challenge.

(b) Brazil has failed to identify the measures it is challenging "as applied"

50. The distinction between a challenge to a programme "as such", "as applied" and to specific transactions is important given the lack of clarity in Brazil's claims. As Canada emphasized in its answer to the Panel's Question 5, Brazil failed to make this distinction in its claims. None of Brazil's claims in its request for the establishment of a panel, other than those relating to Air Wisconsin, identify specific transactions.

51. In its response to Question 26, Brazil argues that to show that individual transactions under a programme are inconsistent with a Member's obligations "should be sufficient" for a finding that a programme is inconsistent "as applied". Not only should it not be sufficient, it cannot be sufficient, as a matter of logic.

52. Even if Brazil could identify specific transactions under a programme that were inconsistent with Canada's SCM Agreement obligations – and it cannot – this would only mean that, in the case of those specific transactions, a programme *has been applied* inconsistently with Canada's obligations. However, this would not mean that all transactions under the programme are or will be inconsistent with those obligations. Brazil has failed to identify under Canada Account, Corporate Account or IQ, a single transaction that is inconsistent with Canada's obligations. Even if it had done so, this would demonstrate only that the transaction is inconsistent, not that all transactions under the programmed "as applied" are inconsistent.

(c) Brazil alone is responsible for its failure to identify the measures it is challenging

53. Brazil seeks to blame Canada for its failure to identify the specific transactions it is challenging. Canada is at fault, according to Brazil, because it has not notified any of its challenged measures under Article 25 of the SCM Agreement and because it allegedly refused to respond to Brazil's questions during consultations. These assertions are not tenable.

54. Article 25 requires the annual notification of subsidies by 30 June of each year. Canada did not notify any subsidies because there were no subsidies it was obligated to notify. As the Appellate Body observed in its Report in *Canada – Aircraft I*, Brazil was entitled to request information under Article 25.8 of the SCM Agreement concerning certain of the EDC's financing measures.[23] Under Article 25.8 a Member can, among other things, seek an explanation of why a measure has *not* been notified under Article 25. Brazil never did this.

55. Moreover, Brazil's allegations regarding the 21 February 2001 consultations are mere posturing. Brazil arrived at the consultations with a wide-ranging list of questions for Canada. Brazil did not provide these questions to Canada in advance of the consultations to enable Canada to investigate and prepare responses. When Canada was unable to answer many of the questions at the consultation, Brazil declared the meeting concluded, told Canada that it would be requesting the establishment of a panel and did so eight days later.

56. Brazil implies that it asked Canada for written responses to its questions and that Canada "refused" to provide them. That is not true. Nor did Canada "refuse" to discuss anything at the consultations, disappointing as those consultations were from Canada's point of view. Brazil cannot use these misrepresentations as an excuse for its failure to adequately identify the measures that it is challenging.

3. Brazil has failed to show that the specific application of Canada's measures is inconsistent

(a) Brazil has failed to show that specific Corporate Account transactions are inconsistent

57. Brazil has failed to show that specific Corporate Account transactions are inconsistent with Canada's WTO obligations. Other than its CIRR argument, which Canada has refuted,[24] the only evidence it has advanced is that Canadian financing exceeds the 10 year limit of the OECD Arrangement.[25] Canada has explained in its submissions why the Arrangement is not necessarily reflective of market terms[26] and that in the commercial market, repayment terms for regional aircraft financing routinely exceed 10 years. Canada confirmed this by its Exhibit CDA-12, which it described in more detail in its answer to the Panel's Question 24.

58. In its comments on this evidence, in response to the Panel's Question 35, Brazil does not actually contest Canada's position that commercially available financing for regional aircraft exceeds 10 years. Nor could it credibly do so, given its position in *Brazil – Export Financing Programme For Aircraft, Recourse by Canada to Article 21.5 of the DSU* (PROEX II). In its response to Question 6 from the Panel, Brazil stated with respect to PROEX, that the 10 year maximum financing period:

[23] *Canada – Aircraft I*, Appellate Body Report, para. 206.
[24] Canada's First Submission, paras. 70-73.
[25] *The Arrangement on Guidelines for Officially Supported Export Credits*, Organization for Economic Co-operation and Development (OECD) 1998, [hereinafter "OECD Arrangement"]. (Exhibit BRA-42)
[26] Canada's First Submission, paras. 70-75; Canada's Oral Statement, paras. 10-13.

> was waived, and continues to be waived, however, for regional jet aircraft only. This is because it is necessary for Brazil to provide regional aircraft financing on terms that are consistent with the market.[27]

59. Instead, in response to Question 35, Brazil resorts to inductive reasoning, implying, without saying so, that because it could not find regional aircraft financing in excess of ten years by two particular banks, such commercial financing must not exist. In addition to being logically flawed, Brazil's argument is disingenuous. It claims that Canada has not elaborated on which commercial entities offer terms in excess of ten years but that in *Canada – Aircraft I*, Canada referred specifically to these two banks, Bank of America and Citibank, "as providing financing in the field".

60. A review of paragraph 6.31 of the *Canada – Aircraft I* Panel Report shows that Canada said nothing of the sort. In the paragraph to which Brazil refers, Canada identified those banks as employing trade financing experts, not as providing regional aircraft financing on commercial terms.

61. Furthermore, contrary to Brazil's allegation, in *Canada – Aircraft I*, Canada did identify commercial entities offering financing for regional aircraft in excess of ten years.[28] Canada identified, for example, the 1997 issuance by Northwest Airlines of pass-through certificates financing 12 British Aerospace Avro RJ85 aircraft. The term for the 1997-1A (Class A) certificates is 18.25 years (from September 1997 to January 2016): *Northwest Airlines* 1997-1 *Pass Through Trusts*, Credit Suisse First Boston, Lehman Brothers, Morgan Stanley Dean Witter, Prospectus 16 September 1997, at pp. S-1, S-5 and S-6.[29]

62. Canada also identified the 1997 issuance by Continental Airlines of pass-through certificates financing nine Embraer EMB-145ER Regional Jets. The term for the 1997 3A (Class A) certificates is 15.25 years (from December 1997 to March 2013): *Continental Airlines* 1997-3 *Pass Through Trusts*, Morgan Stanley Dean Witter, Prospectus, 23 July 1997, at pp. 1, S-3.[30]

63. The Morgan Stanley Dean Witter Report, filed as Exhibit CDA-14, offers additional evidence that the standard length of financing available in the market for regional aircraft financing ranges from 10 to 18 years.[31] This report contains information on structured transaction pricing in the commercial marketplace. It indicates that US airlines have financed regional aircraft in the market using enhanced equipment trust certificate (EETC) tranches that feature a greater than 10 year term of maturity. For example, the EETC Class A and B tranches issued on 19 September 1997 by Atlantic Coast Airlines for 6 CRJ-200 and 8 British Aerospace J-41 aircraft have terms of maturity of respectively 16 years (Class A) and 13 years (Class B).[32] Other examples include Midway EETC tranches issued on 6 August 1998 for 8 CRJ-200, with terms of maturity of approximately 16.5 and 14.5 years.[33]

64. In sum, Brazil has failed entirely to demonstrate that in any instance in which Canada granted financing terms in excess of ten years, those terms were more favourable than those available in the market and therefore conferred a benefit.

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[27] *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, Annex 2-4, p. 135.

[28] *Canada – Aircraft I*, Canada's Appellee Submission, 28 May 1999, para. 64 and footnote 55.

[29] *Northwest Airlines 1997-1 Pass Through Trusts*, Credit Suisse First Boston, Lehman Brothers, Morgan Stanley Dean Witter, Prospectus, 16 September 1997. (Exhibit CDA-54)

[30] *Continental Airlines 1997-3 Pass Through Trusts*, Morgan Stanley Dean Witter, Prospectus, 23 July 1997. (Exhibit CDA-55)

[31] "EETC Market Update: Monthly Update: Airlines" (Morgan Stanley Dean Witter, Fixed Income Research, North America, Investment Grade Credit – Industrials) 10 February 2001. (Exhibit CDA-14)

[32] *Id*., p. 13.

[33] *Id*., p. 15.

(b) Brazil has failed to show that specific IQ transactions are inconsistent

65. Brazil has failed to meet its burden of showing that IQ financing assistance "as applied" to regional aircraft transactions constitutes a subsidy. As described at paragraph 30 of this Submission, the criteria applied to transactions for which IQ assistance has been requested ensure that the financing assistance is being offered on market terms.[34] Accordingly, there is no benefit within the meaning of Article 1 of the SCM Agreement.

66. In its answer to the Panel's Question 14, Canada also explained that, in exchange for its guarantees, IQ receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure.

67. On a commercial basis, this fee is justified by the fact that [].

68. As a result, and consistent with the IQ criteria set out in Exhibit CDA-51, IQ's involvement in regional aircraft financing transactions is on terms no more favourable than those available in the market and does not confer a benefit within the meaning of Article 1 of the SCM Agreement.

(c) Brazil has failed to show that specific Canada Account transactions are inconsistent

69. The only Canada Account transaction that Brazil has challenged is that involving Air Wisconsin. Canada's position is that the offer to Air Wisconsin was made on a matching basis in response to an offer of Brazilian government supported financing to Air Wisconsin by Embraer. Canada's offer therefore qualifies for the "safe haven" of the second paragraph of Item (k) to Annex I to the SCM Agreement. Canada's response to Brazil's argument that Canada's matching offer does not qualify under Item (k) is set out in section B below.

70. Moreover, although Brazil seems to be suggesting, in its response to Question 32, that the second Embraer offer was made "to compete with the offer made by Bombardier and Canada," that second offer is dated 29 December 2000. This predates Canada's matching offer. Canada's offer was not announced until 10 January 2001 and the letter of offer was not issued until 10 May 2001. This confirms that Canada's offer was made in response to that of Embraer or Brazil, contrary to what Brazil appears to suggest in its response to Question 32.

71. However, Brazil also maintains that Embraer's offer to Air Wisconsin did not involve a commitment of Brazilian government support.[35] In its response to Question 32, Brazil seems to be acknowledging what its Exhibit BRA-56 makes clear: Embraer's second offer [] to the benefit of Air Wisconsin. This is consistent with the information provided by Air Wisconsin to [].[36]

72. It is also consistent with Embraer's 31 March 2001 Interim Financial Statements, which discloses Embraer's continuing dependency on PROEX support. The statement warns:

> If the ProEx programme or another similar programme is not available in the future, or if its terms are substantially reduced, the customers' financing costs could be

[34] See Exhibit CDA-51.

[35] See Brazil's Response to Question 31, second paragraph. Brazil does not state whether Embraer made its offer in the expectation of receiving Brazilian government support.

[36] Canada's Confidential Exhibit CDA-1.

higher and the cost-competitiveness of the Company in the regional jet market could decrease.[37]

73. If, nevertheless, the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms claimed by Embraer and Brazil, and without Brazilian government involvement, those terms would be, by definition, market terms. Although Brazil's Exhibit BRA-56 is silent as to certain terms that one would expect to see in an offer of this sort such as administration fees, Canada notes that the number of aircraft offered, the financed amount and the repayment term offered by Canada are, together, no more favourable than the terms Brazil alleges to be commercial market terms. The Canada Account offer therefore would not confer a benefit within the meaning of Article 1 of the SCM Agreement.[38]

B. THE SCM AGREEMENT PERMITS CANADA'S OFFER ON A MATCHING BASIS IN RESPONSE TO BRAZIL'S OFFER TO AIR WISCONSIN

74. The matching provisions of the OECD Arrangement are expressly permitted by, and conform to, the OECD Arrangement. Moreover, the matching provisions of the Arrangement are "interest rates provisions" within the meaning of the second paragraph of Item (k). Accordingly, because Canada's action with respect to Air Wisconsin was on a matching basis as expressly permitted by the "interest rates provisions" of the OECD Arrangement, the transaction qualifies for the "safe haven" of the second paragraph of Item (k).

1. Matching is in conformity with the "interest rates provisions" of the Arrangement

75. In Brazil's response to Question 36 from the Panel, Brazil states that "[r]ecourse to the matching provisions of the OECD Arrangement does not constitute 'conformity with' the 'interest rate provisions' of the OECD Arrangement." Brazil also claims that the ordinary meaning of Item (k), in its context, along with the object and purpose of the SCM Agreement supports this interpretation. For this assertion, Brazil relies on the reasoning of the *Canada – Aircraft I* Article 21.5 Panel ("Article 21.5 Panel").[39]

76. Canada has demonstrated that the Article 21.5 Panel's interpretation does not follow the ordinary meaning of the second paragraph of Item (k).[40] It is illogical to say that a matching transaction – which includes the rate of interest and other terms – can be specifically permitted by the OECD Arrangement and yet condemned as not "in conformity" with the Arrangement's "interest rates provisions". The Article 21.5 Panel tried to justify this result by an argument that interprets "interest rates provisions" extremely narrowly – effectively to mean only the normal permitted rate without any other terms. The Panel then tried to escape the illogic of such a result by selectively bringing in other provisions such as the amount financed and length of financing term on the theory that they are measures of whether the financing is "in conformity". This is a strained reading in comparison to the

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[37] *Embraer – Empress Brasileira de Aeronática S.A.: Interim Financial Statements Together with Report of Independent Public Accountants, March 31, 2001*, pp. 22-23 (complete document is available at http://www.embraer.com/english under Investor Relations, Financial Statements, Filed in SEC). (Exhibit CDA-57). *Embraer – Empress Brasileira de Aeronática S.A.: Financial Statements Together with Report of Independent Public Accountants, December 31, 1998, 1999 and 2000*, pp. F-2, F-92 (complete document is available at http://www.embraer.com/english under Investor Relations, Financial Statements, Filed in SEC). (Exhibit CDA-58)

[38] Canada has also been able to shed some light on the reference to [] in Embraer's first offer to Air Wisconsin. The so-called [] rate is, generally, a rate applicable to commercial real property mortgages denominated in British sterling. Canada has found no evidence that it is a rate available in international capital markets.

[39] See Brazil's Response to Question 36, first paragraph and eighth to tenth paragraphs.

[40] See Canada's First Submission, paras. 51-57, and Canada's Oral Statement, paras. 22-26.

interpretation proposed by Canada, which would include matching transactions specifically permitted by the Arrangement.

77. Brazil's response to Question 36 does not respond to Canada's argument that matching is specifically "permitted" by, and in conformity with, the provisions of the Arrangement, and thereby is in conformity with the "interest rates provisions" of the Arrangement.

78. Moreover, Canada demonstrated in its Oral Statement at paragraphs 27 through 40 that matching is consistent with the object and purpose of the SCM Agreement.

2. Canada complied with its WTO obligations when it matched Brazil

(a) The MFN rule of Article I is not an obligation on the WTO generally to ensure that all of its rules apply equally

79. In its response to Question 36 from the Panel, Brazil argues that "matching" results in a violation of the most-favoured-nation requirements of Article I of GATT 1994.[41] This argument, in each of its forms, is wholly without merit and must fail.

80. Article I is an obligation addressed to Members to accord most-favoured-nation ("MFN") treatment to products of other Members. Article I is not, as Brazil appears to argue, an obligation that requires all rules written under the WTO to benefit equally the trade of each WTO Member. Such an interpretation is utterly without support in the text of Article I of the GATT or any other MFN rule of the WTO.

81. Were there some obligation to write or interpret WTO obligations so that each rule equally benefits all, as Brazil seems to argue, then special and differential treatment of developing countries under any of the WTO agreements would be forbidden, as would any other rule or exception that *de facto* or *de jure* could be argued to benefit one Member or group of Members more than others.

82. Thus, while Canada does not agree with Brazil that the rule allowing matching favours Participants to the Arrangement over non-Participants, there is in any event no basis for claiming that Item (k) does or could constitute a violation of Article I of the GATT.

(b) Canada offered financing to Air Wisconsin on a matching basis in good faith and using reasonable due diligence in response to Brazil's offer

83. In Canada's view, the term "interest rates provisions" used in the second paragraph of Item (k) includes all substantive provisions that determine what interest rates are permitted, and that affect what the interest rate and the amount of interest will be in a given transaction. In Canada's view "interest rates provisions" would exclude procedural requirements with which a non-Participant inherently could not comply.[42]

84. Matching in the context of the OECD Arrangement qualifies for the "safe haven" of Item (k) because the substantive matching provisions of the Arrangement, i.e., Article 29 of the main text and Articles 25 and 31 of Annex III, are in "conformity" with the "interest rates provisions" and indeed are themselves "interest rates provisions".[43] The "safe haven" of Item (k) is available to any WTO Member that complies with these provisions. The procedural requirements of the Arrangement such as notification are not "interest rates provisions", and in any event could not be complied with by non-

[41] See Brazil's Response to Question 36, fifteenth to seventeenth paragraphs.
[42] See Canada's First Submission, para. 56 and Canada's Oral Statement, para. 32.
[43] See Canada's First Submission, para. 49.

Participants. However, just as under the Arrangement a Participant must undertake due diligence when matching,[44] a WTO Member seeking to rely on the matching provisions must act in good faith and on the basis of reasonable due diligence.

85. Canada offered debt financing to Air Wisconsin on a matching basis, in good faith and following reasonable due diligence, in response to Brazil's offer. Government of Canada officials met with officials from Air Wisconsin and United Airlines on 19 December 2000 in Ottawa. The Government officials posed a variety of questions to Air Wisconsin. From the responses of Air Wisconsin, Canada concluded that the Embraer offer involved Brazilian government export financing support with [].

86. The information Canada received at the meeting was consistent with evidence that Brazil was continuing to offer prohibited export subsidies generally and in specific transactions. At approximately the same time as the Brazilian offer was made to Air Wisconsin, Brazil made similar offers of official support in the context of campaigns for the sale of regional aircraft to SA Airlink, a South African airline and Japan Air System.[45]

87. Air Wisconsin's responses also corroborated previous statements by Brazilian officials, including Brazil's then Minister of Foreign Affairs, Luis Felipe Lampreia, who stated that: "[f]or us, the interest rate is the OECD rate, the coverage is 100 per cent and there are no limits on the length of terms".[46]

88. In response to Brazil's financing offer to Air Wisconsin, Canada offered Air Wisconsin debt financing on a matching basis. Canada offered a [] rate with a repayment term of [] years and a loan-to-value ratio of [] per cent.[47] In the light of all the evidence from Air Wisconsin, other airlines and the admission of Brazil's own Minister of Foreign Affairs, Canada's offer to Air Wisconsin on a matching basis was made in good faith and on the basis of reasonable due diligence. Accordingly, Canada's offer to Air Wisconsin is in conformity with the "interest rates provisions" of the Arrangement.

(c) Canada's offer to Air Wisconsin on a matching basis meets the procedural requirements of the Arrangement.

89. If the Panel is of the view that some of the procedural requirements of the Arrangement are actually substantive provisions that determine what interest rates are permitted, and that affect the interest rate and what the amount of interest will be in a given transaction, or if some of the procedural requirements are actually "interest rates provisions", Canada's offer to Air Wisconsin is still in conformity with the "interest rates provisions" of the Arrangement.

90. Brazil puts forth four arguments why Canada's offer to Air Wisconsin on a matching basis does not meet the procedural requirements of the Arrangement.[48] Each of Brazil's arguments fails.

91. First, citing Article 53(a) of the Arrangement, Brazil argues that Canada did not "make every effort to verify" that the non-conforming terms offered by Embraer were "officially supported" by Brazil because Canada did not ask Brazil. Upon a review of Article 53(a) of the Arrangement, it is

[44] OECD Arrangement, Articles 50-53.
[45] See Confidential Exhibits CDA-4 and CDA-5.
[46] See Exhibit CDA-6.
[47] Air Wisconsin will have the option to choose between [] or a [] for each of the [] aircraft. In the case of a [] structure, with respect to [] aircraft, the Government of Québec is providing a guarantee to the equity investor for an amount equal to [] per cent of the sale price of each aircraft.
[48] See Brazil's Response to Question 36, fourth to seventh paragraphs.

immediately evident that the text of Article 53(a) does not require asking the non-Participant being matched if it is providing official support at terms more favourable than those generally envisaged under the Arrangement. The drafters of the Arrangement could have easily created such a requirement, if asking the non-Participant was required, as they did for Participants in Article 52.

92. Moreover, there was no reason to contact Brazil. Brazil is, even today, denying its involvement in the offer to Air Wisconsin. However, it is not plausible that Embraer could have arranged financing of the magnitude offered – [] – for a relatively low quality credit such as Air Wisconsin on the terms that Embraer was proposing without Brazilian official support. Indeed, the mention of [], and the past practice of the Brazilian government would have afforded no basis for anyone to doubt that Brazilian official support would be provided.[49]

93. Brazil attempts to explain away the [].[50] However, Embraer by its own admission continues to rely heavily on official support from Brazil.[51] Given this admission, it is highly likely that the financing of the magnitude offered on those terms was officially supported by Brazil.

94. Canada did exactly what the text of Article 53(a) requires. It made "every effort to verify that these terms and conditions are officially supported." Canada did this by going directly to Air Wisconsin.[52]

95. Brazil's second argument is that Canada has not demonstrated that Canada has informed and notified other Participants. This argument is without merit and must fail. In response to Question 22 from the Panel, Canada provided a copy of its OECD Arrangement notification. By the notification, Canada fulfilled both the information and the notification requirements of Article 53 of the Arrangement.

96. Third, Brazil argues that non-identical matching is not permitted by Article 53 of the Arrangement. Matching of a non-Participant is explicitly permitted by the Arrangement. Non-identical matching is also explicitly permitted. Nowhere in Article 53 (Matching of Terms and Conditions offered by a Non-Participant) does it state that only identical matching is permitted. Matching in the form permitted under the Arrangement in general comprises both identical and non-identical matching. Matching of a non-Participant can generally be expected to be non-identical matching because non-Participants are not subject to the notification requirements of the Arrangement and have no other obligation to respond to Participants' inquiries. In such instances, as in this case, it is often very difficult, due to confidentiality commitments, to know the precise terms of the initiating offer.

97. Fourth, Brazil argues that Canada's offer to Air Wisconsin was more favourable than Embraer's offer. While Canada's offer was not identical to Brazil's, Canada's offer to Air Wisconsin was not more favourable than Brazil's offer.[53]

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[49] See Exhibit BRA-56 and Brazil's Response to Question 32.

[50] See Brazil's Response to Question 32.

[51] Without Brazilian official support, according to Embraer, Embraer's "cost-competiveness" could decrease. Brazilian official support – now and in the future - seems to have a substantial impact on Embraer. See Note 32 in Embraer's 1998-2000 Financial Statements (Exhibit CDA-57).

[52] In Brazil's Response to Question 34, Brazil seems to question the veracity of Air Wisconsin's written statement (see Exhibit CDA-2) on the basis that Air Wisconsin was contractually obligated to make the statement. Rather than impugn the statement, the contractual obligation supports its veracity. When Air Wisconsin agreed to make the statement, it did so with the knowledge that the statement would be subject to scrutiny in a WTO dispute settlement proceeding. To put such a statement in writing – with knowledge of how it would be scutinized – Air Wisconsin had to be absolutely certain that it was accurate. The contractual obligation simply reflects Air Wisconsin's agreement to make the statement.

[53] See *supra*, para. 73.

98. Therefore, even if the "interest rates provisions" of the Arrangement include some of the procedural requirements of the Arrangement, Canada's offer to Air Wisconsin on a matching basis is in conformity with the "interest rates provisions" of the Arrangement. Canada's offer to Air Wisconsin therefore qualifies for the "safe haven" of the second paragraph of Item (k).

3. Canada's interpretation of the "interest rates provisions" treats all Members equally

99. In its response to Question 36, Brazil argues that an interpretation of the "interest rates provisions" that includes matching removes clarity and certainty about the application of the SCM Agreement for those Members who are not Participants to the Arrangement.[54] Brazil's rationale appears to be that non-Participants would not receive notice of the terms and conditions matched by Participants, and therefore, non-Participants would be disadvantaged vis-à-vis Participants. Brazil then proceeds in the next three paragraphs of its response to use this rationale as the basis for arguing that allowing matching would, in effect, violate Article I of the GATT.[55] All of these arguments can be summarized as follows: in Brazil's view, allowing matching under Item (k) is more favourable to Participants than to non-Participants. As Canada noted in its Oral Statement, it is hardly a disadvantage for non-Participants that they can match without being subject to the transparency requirements of the Arrangement.[56]

100. Brazil alleges that differing views exist among Participants about matching and suggests that those alleged differing views undermine the clarity and certainty concerning the application of the SCM Agreement.[57] Brazil misunderstands the position of the US and the EC. There is no disagreement amongst Participants that matching is an "interest rates provision", and on how the matching provisions of the Arrangement operate.

4. Non-identical matching is an interest rates provision

101. Brazil argues that Canada is disingenuous to claim that non-identical matching is an "interest rates provision" because, in Brazil's view, it leads to a "race to the bottom".[58] As noted above at paragraph 96, Brazil's view ignores that non-identical matching is permitted by, and in conformity with, the Arrangement. And by virtue of the matching provisions being "interest rates provisions", non-identical matching is in conformity with the "interest rates provisions" of the Arrangement.

102. While Canada's offer was not identical to Brazil's offer to Air Wisconsin, Canada's offer was not more favourable than Brazil's, i.e., it did not undercut Brazil's offer.[59] Contrary to what Brazil appears to suggest, the matching provisions of the Arrangement do not permit undercutting.[60] Brazil's statement that non-identical matching is "not really matching at all" suggests that matching can only be considered if the matching offer was identical to the initiating offer.[61] This is an impossible test to

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[54] See Brazil's Response to Question 36, eleventh to fourteenth paragraphs.
[55] See *id*., fifteenth to seventeenth paragraphs.
[56] See Canada's Oral Statement, paras. 37-40.
[57] See Brazil's Response to Question 36, fourteenth paragraph.
[58] See *id*., eighteenth paragraph.
[59] See *supra*, paras. 73 and 85-88.
[60] It is unclear to Canada whether Brazil believes that undercutting is or is not permitted by the matching provisions. Brazil's argument that Canada's offer must be equal to, and not more favourable than, Embraer's offer, would seem to indicate that Brazil believes undercutting is not permitted. See Brazil's Response to Question 36, seventh paragraph. However, Brazil's "race to the bottom" argument seems to indicate that Brazil believes undercutting is permitted. *Id*., eighteenth paragraph. In any event, in Canada's view, under the matching provisions of the Arrangement, non-identical matching must not be more favourable, to the best of the Member's knowledge, than the initiating offer.
[61] See *id*., eighteenth paragraph.

meet, as it would require competitors to "share" their offers and to use identical financing tools and structures. In fact, non-identical matching is permitted by the Arrangement both because a matching Participant may have imperfect information, for example, when matching a non-Participant, and because different credit agencies have different means of providing export credits.

103. Matching, by definition, implies equal or similar attributes. Therefore, a Member that intentionally or carelessly undercut an offer by another Member would not be matching and could not rely on the "safe haven" of Item (k). Canada did not undercut Brazil's offer. Canada neutralized the unfair advantage for Embraer that resulted from Brazil's support and allowed Air Wisconsin to make its decision solely on the merits of the aircraft.

104. Brazil's "race to the bottom" argument is wrong. The "interest rates provisions" include matching, not undercutting. The success of the Arrangement in disciplining officially supported trade-distorting export subsidies demonstrates that the fears of a "race to the bottom" are misplaced. Matching is one of the key elements in the success of the Arrangement in imposing discipline on officially supported export subsidies. The strengthening of the export subsidy disciplines that matching provides to the Arrangement applies equally to the SCM Agreement because matching is an "interest rates provision" under the second paragraph of Item (k).[62]

105. For all these reasons, the SCM Agreement permits Canada's offer on a matching basis in response to Brazil's offer to Air Wisconsin. Specifically, Canada's offer to Air Wisconsin on a matching basis is in conformity with the "interest rates provisions" of the Arrangement. Canada's offer to Air Wisconsin therefore qualifies for the "safe haven" of the second paragraph of Item (k).

III CONCLUSION

106. Brazil has failed to substantiate its claims in this dispute. It has failed to establish that Canada's Corporate Account, Canada Account or IQ programmes are "as such" prohibited export subsidies. It has also failed to establish that specific transactions in which these programmes are applied involve prohibited export subsidies.

107. In the case of the Air Wisconsin transaction, Brazil has claimed that Embraer's offer to Air Wisconsin did not involve Brazilian government support and that Canada therefore could not have made a matching offer under Item (k) of Annex I to the SCM Agreement. Brazil's claim lacks all credibility. If this Panel finds that Embraer's offer to Air Wisconsin did involve Brazilian government support, it should also find that Canada's offer on a matching basis qualifies for the "safe haven" of Item (k).

108. Alternatively, if the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms offered by Embraer, those terms would necessarily be market terms. Canada's offer, being no more favourable than those terms, would not confer a benefit and would not be a subsidy within the meaning of Article 1 of the SCM Agreement.

109. Accordingly, Canada respectfully requests that this Panel dismiss each of Brazil's claims.

[62] See Canada's Oral Statement, paras. 34–36.

ANNEX B-9

RESPONSES OF CANADA TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(26 July 2001)

Following are Canada's answers to the Panel's Questions of 20 July 2001. Certain of the Panel's questions, particularly Questions 43 and 44, ask Canada to respond to specific arguments in Brazil's second written submission prior to the second substantive meeting with the parties. While Canada is pleased to provide responses as requested, in accordance with the working procedures, Canada reserves the right to elaborate on its answers by way of formal rebuttal at the second substantive meeting.

Question 37

Since 1 January 1995, was any government guarantee or support provided to Comair or Midway by EDC and / or IQ? If so, please provide full details of the terms and conditions of the relevant transaction(s), and all documentation regarding the review of the transaction(s) by EDC and / or IQ.

1. **Midway:** In its first submission, Brazil argued that EDC's involvement with Midway was a financial contribution. Canada responded that EDC had no involvement with the Midway transaction. Again: EDC was not involved in the Midway transaction.

2. At paragraph 66 of its second submission, Brazil seems to assert that it only learned in Canada's 6 July answer to the Panel's Question 14 that support for the Midway transaction came from IQ. Paragraph 91 of Brazil's 30 May first submission belies this assertion. There, Brazil states that it understands IQ to have been involved in the Midway transaction. In its answer to Question 14, Canada provided the Panel with the full details of the terms and conditions of IQ's involvement in the Midway transaction.

3. **Comair:** At paragraphs 43 and 59 of its first submission, Brazil appeared to assert that it was government guarantees by EDC Corporate Account to Comair that were the basis for some sort of claim in respect of that transaction, or possibly a part of what Brazil has since characterized as its "as such" claim against EDC. In response, Canada stated that EDC's Corporate Account has not provided guarantees to Comair. (Nor has IQ had any involvement in any Comair transaction).

4. In both paragraphs 43 and 59 of its first submission, Brazil put the emphasis on government guarantees, not Canada. Brazil even italicized the term in paragraph 43 so that there would be no doubt that such alleged guarantees were the basis of its complaint. Until its second submission, Brazil never suggested that it is challenging the Comair transaction other than in respect of government guarantees. Moreover, in citing the Comair Form10-K in its first submission, Brazil omitted a paragraph. The omitted paragraph makes clear that Comair's description of how it "expects" to finance certain aircraft relates not to the delivered aircraft identified by Brazil, but to the scheduled

delivery of other aircraft after 31 March 1998. It is only logical that Comair's financing *expectations* would apply to future deliveries, not aircraft already delivered.

5. EDC provided []. These Corporate Account transactions were authorized in 1996 and 1998 and [] for the ASA transactions described by Canada in its response to the Panel's Question 11.[1]

6. Canada's Exhibits CDA-58 and CDA-59 contain the letters of offer and the documentation outlining the pricing for these loans. The documentation makes clear the efforts to which EDC went to ensure that the transaction was financed at market terms.

7. For ease of understanding, Canada also offers the following synopsis:

- Pricing for the first Letter of Offer was set in April 1996 and was based on an imputed rating of [], derived from the airline's most recent financial results – LA Encore was not introduced until mid-1997. At that time the Bloomberg Fair Market Curve (FMC)[2] indicated that [] rated US industrials were borrowing at 10 year US Treasury Bills (UST) + []. Today, given the availability of LA Encore, after inputting Comair's 1994, 1995 and 1996 results into LA Encore we find that the 1996 rating is calculated as []. The FMC for [] credits at the time of the transaction was 10 year UST + []. Then current market pricing for Comair, which was provided to EDC in confidence by a reputable financial institution, was also considered; EDC was advised that [] Comair deliveries at that time were priced by 3-4 European banks in the 10 year UST + [] range with similar repayment terms, average life and loan to value ratios as the EDC proposal. Finally, then current EDC pricing offered to other airlines was also considered. Based on all of the above, the first EDC Letter of Offer issued to Comair (16 July 1996) carried an interest rate of 10 year UST + []. This market-based pricing was [] bps below the [] and was authorized.

- Letters were issued to Comair in December 1996 and March 1997, which offered Comair a ten year repayment and an interest rate of 10 year UST +[]. This pricing was offered as a result of Comair's strong financial performance and the fact that Comair had been able to receive bids for financing up to [] aircraft at UST+[] through a EETC with a [] year repayment term, although EDC estimated that all-in pricing, including all requisite fees, would actually be closer to UST + []. In addition, at the time of these offers [] rated credits were attracting rates of 10 year UST + [] and [] rated credits were trading at 10 year UST + [] according the []. This EDC market-based pricing was [ ] and was authorized.

- By the time of the next Letter in August 1997 LA Encore was operational and a rating of [] was calculated for Comair. The offered interest rate of 10 year UST + [] was based on Comair's continued strong performance as well as the previously noted benchmarks (banks, EETCs) and pricing offered by []. In addition, recent pricing for [] was also considered as this airline was deemed to be a similar risk. At the time of this Letter the FMC for [] rated credits indicated 10 year terms of 10 year UST + []. An [] of [] was required and authorized based on the above noted market benchmarks.

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[1] [].

[2] The Bloomberg Fair Market Yield Curve or Fair Market Sector Curve (FMC) is used to compare yields across maturities of multiple bond sectors and ratings. The Curve allows one to compare sector curves to benchmark curves (e.g. US Treasuries) to determine current spreads. Curves within the same sector can be compared with the benchmark as well as those with a different rating. FMC's are created using prices from new issue calendars, trading/portfolio systems, dealers, brokers and evaluation services which are fed directly into the specified bond sector databases on an overnight basis.

- On 18 August 1997 EDC agreed to allow Comair to stretch the average life of the debt component of the USLL transactions to [] years from []. Comair's request for this was reviewed by EDC based on the debt exposure over the term of the loan and a reduction in the loan-to-value ratio (LTV). EDC deemed acceptable the risk associated with this change, based on consideration of data available at that time from recognized aircraft appraisers of projected CRJ residual values in comparison with the exposure profile under the proposed financing. This option required the loan to value ratio to be reduced to [] per cent. All other terms and conditions remained unchanged.

- Similarly, a term included in EDC's 17 September 1997 Letter was up to a [] year average life with the LTV restricted to [] per cent. All other terms and conditions remained unchanged.

- On 31 March 1998 EDC issued a Letter of Offer which, in addition to the terms and conditions offered in previous Letters, offered a direct loan option with a ten year repayment and an interest rate of 7 year UST + [] or LIBOR + []. This pricing considered Comair's financial performance (then rated [] by LA Encore) and similar pricing offered to []. The floating rate was based on then current swap rates. The [] for 31 March 1998 indicated [] credits were attracting 7 year UST + []/10 year UST + [].

- On 14 April 1998, EDC offered up to a [] year repayment term under the direct loan option (though the direct loan option was never utilized by Comair). Financing under the USLL structure allowed up to an [] year average life, subject to a LTV of [] per cent. Also considered were: appraisers' residual value projections and the EDC debt profiles. Approval of an [] of [] basis points was duly authorized based on the commercial pricing benchmarks noted.

- In February 1999, EDC issued its most recent Letter to Comair. This Letter provided the airline with the option of a fixed rate (10 year UST + []) or a floating rate (six-month US dollar LIBOR + []) and tied the swap to a market-based benchmark for advances after March 2000. Pricing was based on the airline's credit quality, deemed [] and considered first among its peers in the industry. Also considered were pricing for similar credits both internal to EDC and available in the market (including airlines and industrials, e.g. the []) and then applicable swap rates between UST and LIBOR. Based on these market-based considerations an [] of [] bps was obtained for the fixed rate option ([] was met under the floating rate option).

Question 38

Please provide full details of the terms and conditions of any SDI support provided in respect of the Atlantic Southeast and Northwest transactions discussed at para. 91 of Brazil's first written submission. Please also provide all documentation regarding the review of any relevant transaction(s) by SDI. Please also provide the credit ratings of the airline(s) at the time of the relevant transaction(s).

1. SDI did not participate in either the Atlantic Southeast or the Northwest transactions. Nor did IQ, as Canada stated in its answer to Question 14 from the Panel.

Question 39

Please respond to the suggestion (in para. 132 of Brazil's second written submission) that Canada has failed to explain the use of $135 million of the (approx.) $300 million of IQ funding referred to in the press article cited in paragraph 85 of Brazil's first written submission.

1. Brazil contends that "[a]s a matter of simple math, the list of transactions included in Canada's response to Question 14 cannot be complete." Brazil is wrong. Canada has included all of the transactions in which IQ was involved. Brazil has failed to take into account that the newspaper article on which Brazil relies was using Canadian dollars, whereas the $20 million that Brazil uses as the average price for a Bombardier aircraft is a US dollar amount. What Brazil describes as a difference of nearly $135 million dollars is mostly due to its failure to adjust for the difference in the value of the Canadian and US dollars.

2. For example, at a current exchange rate of approximately CAD 1.545 per USD, Brazil's estimate of USD $164.6 million in committed funds becomes approximately CAD 254.3 million. Furthermore, it is IQ's practice, whenever it does financing, to keep funds in reserve in order to guard against possible variations in exchange rates. This accounts for most, if not all, of the remaining difference.

3. In addition, as both the article and the Panel's question make clear, the reference to $300 million is an approximation by the author of the article. Thus, contrary to Brazil's assertion, in paragraph 132, that Mr. Cyr "stated that $300 million had been used", the reference in the article is to "[a]bout $300 million" and the article is careful not to attribute this estimate to Mr. Cyr. Finally, as Brazil has acknowledged, the average price of $[] million that Brazil assigned to the Bombardier aircraft is also an approximation.

Question 40

Please provide the credit ratings for Air Littoral, Atlantic Coast Airlines and Air Nostrum at the time of the transactions referred to in Canada's reply to Question 14 from the Panel.

1. None of the airlines were public companies at the time of the transactions in question. [] conducted an internal credit assessment and arrived at the following credit ratings for Air Littoral and Air Nostrum at the time of the transactions:

Atlantic Coast Airlines: []

Air Littoral: []

Air Nostrum: []

2. These internal ratings are calibrated to ratings of international credit rating agencies such as Standard & Poor and Fitch IBCA. For example, ACA is now a public company with a Standard & Poor rating of [].

Question 41

Please provide the documentation requested in Question 14 from the Panel, particularly in respect of the specific guarantee fees involved, and any [], or explain why such documentation is not available.

In addition, please provide all documentation regarding the review by IQ of the Air Littoral, Atlantic Coast Airlines and Air Nostrum transactions referred to in Canada's response to Question 14 from the Panel.

1. Please see Exhibits CDA-60 to CDA-64. In respect of the documentation concerning any [], please see Exhibit CDA-65. This document, entitled [].

Question 42

Please respond to Brazil's comments in paragraphs 137-138 of its second written submission regarding Canada's reply to Question 17 from the Panel.

1. Paragraph 137: Whatever Brazil "suspects", there is no updated version of the "critères d'évaluation". They have remained the same since IQ superseded SDI in 1998.

2. Paragraph 138: Canada provided the "critères d'évaluation" included in its Exhibit CDA-51 in an effort to answer the Panel's question as comprehensively as possible, even thought the "critères" do not fix terms and conditions. No other guidelines etc. exist fixing the terms and conditions of IQ support to the regional aircraft industry. As Canada has explained and as the facts and evidence bear out, subject to the "critères d'évaluation", IQ has very broad discretion in deciding whether to provide such support, and the terms and conditions on which it does so.

Question 43

Please respond to para. 153 of Brazil's second written submission.

1. When Canada stated in its answer to the Panel's Question 23 that, from 1 January 1995 to 31 May 2001, 70.04 per cent of Bombardier's order book was financed in the commercial market, Canada was not including orders in which Canadian government entities participated on what Brazil refers to as a "market window" basis. There was no involvement whatsoever of Canadian government entities.

Question 44

Please respond to paras. 62 and 63 of Brazil's second written submission.

1. **Para. 62:** Brazil asserts that the "question, therefore, is whether – in the absence of EDC – Bombardier could make equally attractive financing available to its customers." Canada understands Brazil to be arguing that Bombardier must show that it could arrange financing in the commercial market on terms as favourable as those offered by EDC to customers of Bombardier. Canada disagrees.

2. Bombardier is not the party requiring financing – the purchaser of the aircraft is. Brazil's proposition ignores the test used by the Appellate Body that a benefit 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.[3] Regardless of whether EDC or another financial institution is providing the financing, the purchaser of the aircraft, not Bombardier must repay the financing. The terms on which it can do so are determined by the attributes of the purchaser, including its credit risk. The terms on which Bombardier could obtain financing are irrelevant to this determination.

[3] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 157.

3. Nor could it be argued that Bombardier receives a benefit if EDC provides financing on terms that the borrower could obtain in the marketplace. Since its first submission, Brazil has gone to great lengths in its argument against Corporate Account and IQ to avoid the "benefit" test applied by the Appellate Body. Brazil's argument in paragraph 62 in respect of Corporate Account continues this pattern.

4. The implication of Brazil's assertion in paragraph 62 is that EDC's operations – or those of any export credit agency – are unnecessary when they offer no more than what the market does. When an ECA operates on market terms, it does not imply that the financing provided will not be attractive to its customers. By definition, all private sector financial institutions provide financing on market terms as well. By Brazil's reasoning, most of these institutions are "unnecessary" as they do not provide anything on better terms than those otherwise available in the market.

5. Borrowers seek out financial institutions with the expertise that best meets their needs. EDC's borrowers seek its depth of experience and specialized expertise in facilitating all aspects of export transactions. Relying entirely on innuendo, Brazil seeks to penalize EDC for being good at what it does. Brazil cannot in this manner avoid its obligation to demonstrate all the elements of a prohibited export subsidy.

6. By Brazil's logic, any financing by an export credit agency would be *per se* illegal. However, that is not what Article 1 and 3 of the SCM Agreement provide. In particular, Article 1 requires not only a financial contribution by a government or a public body, but also that a benefit thereby be conferred. Brazil has not established that EDC Corporate Account financial contributions confer a benefit because its allegations are baseless.

7. In paragraph 62, Brazil also continues the practice of using the Air Wisconsin transaction to argue against Corporate Account. Brazil is fully aware that the Air Wisconsin transaction does not involve Corporate Account. Canada suggests that Brazil has engaged in this practice because Corporate Account transactions are on market terms.

8. Finally, even if Brazil's definition of the issue were appropriate – and clearly it is not – Brazil would still have the onus to demonstrate the existence of a benefit by showing that Bombardier could not arrange "equally attractive financing" in the absence of EDC. Brazil has neither demonstrated this nor made any attempt to do so.

9. **Para. 63:** Throughout this dispute, Canada has confirmed that, as the panel found in *Canada – Aircraft I*,[4] the EDC programme constitutes discretionary legislation. This finding was not based on Item (k). Nothing has changed since the finding of the *Canada – Aircraft I* panel, nor has Brazil submitted any arguments or evidence that show otherwise. Canada's position is not in any way dependent on the affirmative defence in Item (k).

10. Moreover, Brazil's assertion that "A measure that exists to provide export subsidies remains mandatory whether or not it may fall within the scope of the "safe haven" of item (k)" is irrelevant. Even if "existing to provide export subsidies" were the test for inconsistency "as such", Canada has explained previously that EDC exists to provide financing assistance, not subsidies. However, "existing to provide export subsidies" is not the test. The test of whether a measure is "as such" inconsistent with the prohibition on export subsidies is whether the measure must necessarily, at least in some circumstances, result in the granting of prohibited export subsidies. Nothing in the Export

[4] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999.

Development Act[5] or anywhere else, requires EDC, when providing financing, to grant prohibited export subsidies.

11. Brazil's argument in paragraph 63 is in no way relevant to the facts of this dispute or to Canada's arguments. Canada therefore wonders if the Panel has sought comment on paragraph 63 because Brazil has contradicted its own position in *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*. There, Brazil argued that once it "has established 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 vs. discretionary distinction, be considered to be in conformity with Brazil's WTO obligations until Canada proves otherwise."[6]

12. The panel in that proceeding has found that PROEX III is not "as such" inconsistent with the SCM Agreement because, *inter alia*, it allows Brazil to act in conformity with the second paragraph of Item (k). As the panel put it, "Thus, Brazil has successfully invoked the safe haven provided for in the second paragraph of item (k) in respect of PROEX III as such."[7] It is intriguing, if not surprising, that Brazil's position in this dispute amounts to an assertion that the panel in the PROEX III proceeding erred at law.

Question 45

At paras. 74 and 75 of its second written submission, Brazil argues in essence that, for the ASA transaction, "EDC financial contributions were granted on terms more favourable than those available on the market". Please comment.

1. Contrary to Brazil's assertion, the fact that EDC provided Corporate Account financing to ASA at a rate below its usual [] does not "demonstrate that EDC financial contributions were granted on terms more favourable than those available on the market." More particularly, it does not demonstrate that EDC's lending yield resulted in ASA receiving a financial contribution on terms more favourable than those available to it in the commercial marketplace. Nor could it demonstrate this, because the transaction was priced at market terms. EDC's [] is an internal requirement. It expressly provides for the possibility of exceptions. These exceptions may be sought to achieve market pricing as was done in the ASA transaction.

2. As noted in Canada's answer to the Panel's Question 11, at the time of the first Letter of Offer to ASA, LA Encore had not been developed but EDC was able to impute from Famas (commercial financial analysis software) a [] for ASA based on the company's financial results for the previous three years. EDC developed its pricing based on consideration of i) the then current [], ii) the rates paid by the airline on its other debt as well as iii) the rates obtained by a comparable airline, [], on a recent market financing of regional jets. In addition, EDC considered the then current EDC pricing offered to [].

3. As previously described, the [] or Fair Market Sector Curve (FMC) is used to compare yields across maturities of multiple bond sectors and ratings. The Curve allows one to compare sector curves to benchmark curves (e.g. US Treasuries) to determine current spreads. Curves within the same sector can be compared with the benchmark as well as those with a different rating. FMC's are created using prices from new issue calendars, trading/portfolio systems, dealers, brokers and

[5] *Export Development Act*, R.S.C. 1985, c. E-20, s. 10. (Exhibit BRA-17)

[6] *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW/2, not yet adopted, para. 5.122.

[7] *Id*., para. 5.206.

evaluation services which are fed directly into the specified bond sector databases on an overnight basis.

4. At the time of the first Letter of Offer to ASA, generic US industrials with a credit rating of [] were trading at 10 year UST + []. Had LA Encore been operation at the time of the letter, it would have generated a rating of [], based on the company's financial results of the previous three years. At that time, the FMC indicated that such credits were attracting 10 year UST + [].

5. According to ASA's financial statements, as at 31 December 1995, the company had a USD [] unutilized line of credit which was afforded a rate of L + [] (which swapped to fixed rate at the then appropriate spread was equivalent to 10 year UST + []).

6. At the time of the first Letter of Offer to ASA, EDC had previously offered financing to Comair on essentially the same terms. As discussed in Canada's answer to Question 37, at about the same time as EDC's first Offer to ASA, [] was able to attract pricing in the 10 year UST + [] range from a number of European banks for its CRJ acquisition programme and had received a bid for the issuance of a EETC at 10 year UST + [] (estimated to be 10 year UST + [] inclusive of fees and charges). In addition to the referenced face rates, the bank loans and the proposed EETC offered terms and conditions similar to those offered by EDC. At the time of the first Offer to ASA, EDC had previously offered [] financing on essentially the same terms.

7. As noted in Canada's answer to Question 11, the pricing offered in EDC's second Letter of Offer, dated 26 August 1998, was based on the airline's LA Encore rating of [], the then current FMC, EDC's concurrent pricing of its other borrowers (including [], which by then was similarly rated by LA Encore) and the company's continued strong performance. At the time, the FMC for similarly rated [] grade generic industrial credits was in the order of 10 year UST + [].

8. In March 1998 EDC presented a Letter of Offer to [] which provided a face rate of 10 year UST + []. This pricing was based on market benchmarks considered in the [] previous and then current pricing offerings.

9. ASA's financial performance continued to be strong, as demonstrated by its LA Encore credit rating and consistent profitability. It clearly warranted the pricing received from EDC.

10. Finally, as noted in Canada's answer to Question 11, through [] if ASA's deemed or published credit rating fell below certain benchmarks, [] would either purchase the ASA receivable or pay EDC a predetermined incremental interest margin as described therein.

Question 46

Please explain in more detail, (in addition to the statement by an Air Wisconsin official) why and how Bombardier's offers to Air Wisconsin "matched" the terms of Embraer's offer. Does Canada take the view that Bombardier's financing terms were "economically equivalent to Embraer's offer" (see para. 89, Brazil's second written submission)? If yes, please explain why and how.

1. As a preliminary matter, Canada wishes to clarify that the "matching" of offers at issue in this proceeding is Canada's matching of official support offered by Brazil, rather than Bombardier's matching of a commercial proposal by Embraer.

2. Canada decided to match in order to establish a level playing field and to ensure that the Canadian bidder was not disadvantaged by Embraer's subsidized financing offer. Canada sought to ensure that the buyer's decision in the Air Wisconsin transaction would not be made on the basis of

the "most favourable officially supported terms".[8] In its rebuttal submission, at paragraphs 85 to 88, Canada has explained the due diligence efforts that it took to ensure that its financing offer matched Brazil's financing offer. These efforts succeeded.

3. Canada is not sure what Brazil means by "economically equivalent", nor does Canada accept that there are any textual or other grounds for using "economic equivalence" as the basis for comparison of matching offers. The question is whether the financing offered by Canada is more favourable than the financing offered by Brazil. The answer is no. Thus, if "economically equivalent" means that each financing package, taken as a whole, has effectively the same value to the borrower (i.e. it is no more favourable), then the answer to the Panel's question is that the terms of Canada's offer were not more than "economically equivalent" to Brazil's offer.

4. In the course of this proceeding, Brazil has been obliged to provide the Brazilian offer to Air Wisconsin. Canada's comparison of the two financing offers, attached as Annex A, shows that there are differences in the two financing offers on a term-by-term basis. However, as Canada explained in paragraph 102 of its rebuttal submission, non-identical matching is permitted by the OECD Arrangement, both because a matching Participant may have imperfect information about the offer being matched and because different export credit agencies use different instruments to provide export credits.

5. The comparison of the two offers demonstrates that, taken in their entirety, the terms of Canada's financing offer are not of more favourable value to Air Wisconsin and may indeed be of less value than the Brazilian offer. For example, the Brazilian offer does not specifically refer to collateral security requirements and proposes [], whereas Canada's offer requires specific security and is limited to []. If this was Brazil's commitment, then the Brazilian offer may well have been significantly more favourable than Canada's. Thus, the comparison of the two offers confirms that, as Air Wisconsin stated in its letter, Canada's offer, viewed in its entirety is no more favourable than that offered by Brazil.[9]

Question 47

In Canada's Rebuttal, para. 32, Canada argues that the guarantee fees charged by IQ when providing support to the regional aircraft industry are "at market". What is the basis of this argument? Also, Brazil argues that the most recent decree (Exhibit Cda 36) eliminates fees as a condition for the grant of a guarantee. Please comment on whether / how the elimination of such fees would make any difference to the Panel's analysis of "benefit" issues.

1. In response to Question 14 of the Panel, Canada explained that IQ "receives both an up-front fee of [] basis points to cover its administrative costs, as well as an annual fee equivalent to [] basis points on its effective exposure."[10] The "market rate" nature of the guarantee can only be demonstrated considering the value of the financial service that is being provided in the light of the risk exposure of the service provider.

2. Canada explained at paragraphs 67 and 68 of its Rebuttal Submission as well as in its responses to question 14 of the Panel that the effective risk exposure of IQ is key to the determination of what constitutes an appropriate fee. As a result of [], IQ risk exposure is greatly diminished. In

[8] OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998), p. 5. (Exhibit BRA-42)

[9] Letter from [], operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001. (Exhibit CDA-2)

[10] Canada's answer to Question 14 of the Panel, para. 7.

fact, [], the risk represented by a possible default of the aircraft purchaser is, in large part, replaced by [].

3. The market nature of the fee is further demonstrated by the commercial practice of the use of the guarantees. As mentioned by Canada in paragraph 9 of its answer to Question 14 of the Panel:

> No Bombardier customer has ever made a regional aircraft purchase contingent on the presence of an IQ guarantee. Indeed, as can be seen in the above transactions, on average, Bombardier customers using IQ equity guarantees have chosen to do so on less than [] per cent of their unit volume.

4. This proves that in practice, IQ provides financing services in competition with other financial institutions interested in participating in the aircraft financing market and that for the great majority of aircraft sold by Bombardier, the IQ guarantee is not sufficiently attractive to Bombardier's customers. In other words, the fact that [] per cent of the aircraft being financed are financed without IQ equity guarantees demonstrates that most of the time, Bombardier's customers are, at best, indifferent to IQ equity guarantees. The necessary implication of these circumstances is that the fees charged by IQ in return for the guarantees are market rate; otherwise Bombardier's customers would not be so indifferent as to their availability.

5. Given that [ ]the fees that are charged [] are more than adequate to compensate it for its risk and service.

6. The second part of the Panel's question relates to Brazil's argument that Decree 1488-2000[11] (the most recent decree) eliminates fees as a condition for the grant of a guarantee. If by this argument, Brazil is implying that IQ no longer charges fees, Brazil is mistaken. Decree 1488-2000 does not eliminate fees as a condition for the grant of a guarantee. Decree 1488-2000 does not specify the nature or the amount of the fees that may be charged by IQ. Instead, the fees to be charged are subsumed into IQ's discretionary power, subject to the "critères d'évaluation" set out in Exhibit CDA-51, to stipulate whatever terms and conditions it requires before it will provide a guarantee. Indeed, if IQ did not charge an appropriate fee, it could not satisfy "Critère B", which provides that IQ's support will not be available if the remuneration IQ is called upon to receive is less than that offered in the market for an arm's length transaction of similar structure and risk.

7. The Air Wisconsin transaction is the best evidence that contrary to Brazil's contention, Decree 1488-2000 does not eliminate fees. As described in more detail in the answer to Question 48, below, IQ is charging fees for its participation in the Air Wisconsin transaction.[12] In fact, IQ has charged fees for every transaction in which it has participated and has provided for fees in every financing offer it has made.

8. Because the fees in question have not been eliminated the questions of whether and how the elimination of such fees would affect the Panel's "benefit" analysis are moot.

Question 48

At paras 66 and 67 of its second submission, Canada states that IQ charges an up-front fee of [] basis points, and an annual fee equivalent to [] basis points on its effective exposure. In addition, Canada asserts that IQ is provided with a []. In its letter of 25 June 2001, which

[11] Décret 1488-2000, 20 décembre 2000, concernant une participation de 226 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc. (Exhibit CDA-36)

[12] See Canada's 25 June 2001 Letter to the Panel, last sentence of "Investissement Québec Guarantee – Transaction Description": "[]."

includes details of IQ's participation in the Air Wisconsin transaction, there is no reference to either an annual fee, or to a []. Please explain why IQ's participation in the Air Wisconsin transaction does not appear consistent with the practice set forth in the above mentioned paras 66 and 67.

1. IQ's participation in the Air Wisconsin offer is consistent with the practice set forth in paragraphs 66 and 67 of Canada's second written submission. Canada's 25 June 2001 letter indicates that IQ charges a fee of [] basis points per annum.[13] As explained above, in paragraph 5 of Canada's answer to Question 47, []. Furthermore, IQ's participation is subject to the usual conditions such as due diligence. Depending on the outcome of that due diligence, it is possible that IQ's fees could exceed [] basis points (on the [] per cent exposure) but they will not be lower than [] basis points.

2. The up-front [] basis point administration fee is always charged by IQ pursuant to its obligation to self-finance its operations, in accordance with Section 40 of the IQ Act.[14] Such a [] basis point administrative fee is routinely charged by any commercial financial institution.

3. The lack of reference to a [] in the description of the Air Wisconsin offer is because that []. However, pursuant to Decree 879-97, [].[15]

ANNEX A

COMPARISON OF THE FINANCING OFFERS TO AIR WISCONSIN

Category	Canada	Brazil

[13] See *id*., last sentence of the last paragraph.

[14] *An Act Respecting Investissement-Québec and Garantie-Québec*, L.R.Q. c. I-16.1, s. 40. (Exhibit BRA-18)

[15] Décret 879-97, 2 juillet 1997, concernant la participation de la Société de développement industriel du Québec relativement à la vente d'avions par Bombardier Inc., pp. 2-3, sub-para. (c)(ii). (Exhibit CDA-34)

ANNEX B-10

ORAL STATEMENT OF CANADA AT THE SECOND MEETING OF THE PANEL

(31 July 2001)

I. INTRODUCTION

1. Mr. Chairman, distinguished members of the panel, the facts do not support Brazil's claims. Nor does the law.

2. The facts and the law do not support Brazil's contentions that Canada's programmes "as such" are inconsistent with its WTO obligations. The fact is that there is wide discretion in how each of these programmes is applied. The law is clear: because these programmes do not require Canada, in any circumstances, to grant prohibited export subsidies, they cannot be "as such" inconsistent with the prohibition on export subsidies. Brazil has offered nothing to indicate otherwise or to affect the previous findings of the *Canada – Aircraft I* (DS 70) panel.

3. The facts and the law also fail to support Brazil's contentions that these programmes have been applied inconsistently with Canada's WTO obligations. The law for the purposes of this dispute is clear: unless there is a financial contribution by a government or public body that thereby confers a benefit, there is no subsidy. A benefit is conferred if the recipient receives a financial contribution on terms more favourable than those available to it in the market. If it does not, there is no subsidy.

4. Due to the inadequacy of Brazil's claims and the lack of clarity in its submissions, Canada still does not know which Corporate Account or Investissement Québec transactions it is challenging "as applied". However, Brazil has failed to show that any of the transactions it has mentioned in its submissions involve a financial contribution that thereby confers a benefit. Brazil has failed to meet its burden of proof. Nevertheless, in response to the Panel's questions, Canada has adduced extensive evidence establishing that these transactions are on terms no more favourable than those available to the recipient in the market and therefore are not subsidies.

5. Brazil has challenged only one Canada Account transaction as applied: the Air Wisconsin transaction. There is strong evidence that Embraer's offers did involve Brazilian government support. If so, Canada's offer of support on a "matching" basis qualifies for the safe haven of Item (k), second paragraph. Canada bears the burden of proving this on a *prima facie* basis, and it has done so. Brazil contends that the SCM Agreement affords Canada no right to match Brazilian subsidy offers. Canada has demonstrated that this is wrong as a matter of law. Brazil also contends that even if Canada does have the right to match Brazilian subsidies, its offer to Air Wisconsin has failed to meet the requirements for matching Brazil's offer. As Canada has shown, Brazil's contention is wrong on the law and on the facts.

6. Should the Panel accept, as Brazil argues, that commercial credit rather than government support was available to Air Wisconsin on the terms Embraer offered to arrange through third party institutions, those terms would be, by definition, terms available to Air Wisconsin in the market. Brazil bears the burden of showing that the terms of the financing by Canada are more favourable

than those that Brazil argues were available to Air Wisconsin in the market. Brazil has failed to meet this test. On the contrary, Canada has demonstrated that the terms it offered were not more favourable than those allegedly available to Air Wisconsin in the market.

7. In this statement, Canada will do the following:

- First, Canada will address Brazil's attempt to avoid its burden of proof and its failure to set out its claims with sufficient clarity;

- Then, Canada will elaborate on Brazil's failure to make out its challenge to Canada's programmes "as such", and "as applied" in specific transactions;

8. In sum, Mr. Chairman, Canada will show that when the proper legal tests are applied to the facts of this dispute, Brazil's challenge cannot be sustained.

II. BRAZIL HAS SOUGHT TO AVOID ITS BURDEN OF PROOF

9. Brazil's request for the establishment of a panel claimed that three programmes, Canada Account, "EDC" (by which Brazil seems to mean Corporate Account since it distinguishes it from Canada Account), and Investissement Québec violate various provisions of the WTO Agreement, including Articles 1 and 3 of the SCM Agreement and Article 21.5 of the DSU. Brazil appeared to be claiming that the programmes "as such" violate these agreements. Where, as in its first submission, Brazil referred to certain transactions, it appeared to consider these to be evidence of the inconsistency of Canada's programmes "as such". Brazil's claims also challenged the Air Wisconsin transaction.

A. BRAZIL HAS NOT CLARIFIED ITS "AS APPLIED" CLAIMS

10. However, Brazil has only recently said that it is challenging specific transactions under Canada's programmes "as applied", and it has never said with any clarity, which transactions, or applications, it is challenging. Instead, Brazil has sought to enlist the panel to investigate whether there are applications that could be challenged.

11. As the complainant, Brazil has the responsibility of establishing its claims. With respect to each of the impugned programmes "as such", and each transaction "as applied", Brazil bears the burden of proving, on a *prima facie* basis, two distinct general elements. First, it must show that a subsidy exists within the meaning of Article 1 of the SCM Agreement. Second, it must show that the subsidy, if one exists, is contingent in law or in fact upon export performance. In the place of a *prima facie* case, Brazil has offered suppositions and rhetoric. Brazil seems to consider that if its rhetoric is loud enough, it can persuade the Panel to assist it in its fishing expedition.

12. Brazil persists in these efforts. Its approach to the Kendell transaction is typical. Brazil made blanket assertions that EDC, by definition, took risks that no bank would ever take and that EDC's financing was below market because the term offered to Kendell was []. Canada showed in the Kendell transaction that, in fact, EDC participated in a syndicate of commercial banks. Those banks took the same risks as EDC and provided financing on the same terms as EDC. In other words, the terms offered by EDC were not only not more favourable than those *available* to the recipient in the market, they were identical to those actually *provided* to the recipient by the market.

13. Now, in its response to Question 51, Brazil makes further unsubstantiated allegations about the Kendell transaction. It then asks the Panel to ask Canada to produce still more information.

Brazil's approach to its burden of proof has important implications for the integrity of the dispute settlement process.

B. THE DISCLOSURE OF BUSINESS CONFIDENTIAL INFORMATION

14. The Appellate Body has found that, although a panel cannot relieve a complaining Member of the task of establishing a *prima facie* case, a panel has the broad authority to ask for information. The Appellate Body has said that Members have a duty to comply, whether or not the opposing party has established a *prima facie* case, and that a Member that fails to comply risks having adverse inferences drawn.[16] The Panel in this case has used its authority to make numerous requests for information, much of it of a business confidential and commercially sensitive nature.

15. Canada has complied with the Panel's requests. It has done so despite the unclear and shifting nature of Brazil's complaints, despite Brazil's manifest failure to establish a *prima facie* case, and despite the obvious risks that the sensitive and business confidential information Canada has provided regarding credit agencies and their clients will fall into the hands of their commercial competitors.

16. The information gathering authority found by the Appellate Body to exist in the DSU is not accompanied by confidentiality procedures whose effectiveness can be ensured or enforced. The risks that the business confidential information of a Member's businesses will fall into the hands of its competitors in a complaining Member are particularly high when the competitors in question are government agencies or private entities with close links to the complaining government.

C. BRAZIL SEEKS TO HAVE THE PANEL DEVELOP ITS CASE

17. Canada recognizes that the Panel is following the practice suggested by the Appellate Body with regard to information requests. Canada also realizes that requests for "preliminary rulings" are often dealt with at the end of arguments by the parties. Nevertheless, there is a serious problem with requesting sensitive information about transactions that did not appear to be subject to the complaint and about which there has been no showing of illegality. The problem is that a Member with little more than suspicion can use the dispute settlement process to get the panel to develop its case for it.

18. Brazil persists with its approach even now, when the information Canada has provided proves that neither the transactions in the Panel's questions nor the programmes "as such" involve prohibited subsidies. Brazil's response to Question 51 is a good example of the continuing effort by Brazil to promote a prosecutorial "fishing expedition" by the Panel. The Panel should reject this effort.

D. *EXPORT RESTRAINTS* DOES NOT EXCUSE BRAZIL'S FAILURE TO CLARIFY ITS CLAIMS

19. In its second submission, Brazil attempts to rely on *United States – Export Restraints* to excuse its failure to clarify what it now calls its "as applied" claims. In previous submissions, Canada has explained why Brazil's request for the establishment of a panel is inadequate and fails to meet the requirements of Article 6.2 of the DSU. Canada will not repeat those arguments here. However, it is relevant to the foregoing discussion to correct Brazil's assertions regarding the *Export – Restraints* case.

20. Whether a panel request adequately identified measures "as applied" was not genuinely at issue in *Export Restraints*, (despite the United States' efforts to make it an issue), because Canada in

[16] *Canada – Aircraft I*, Appellate Body Report, WT/DS70/AB/R, paras. 192-194.

that dispute was only challenging US measures "as such". This is set out clearly in the Panel's findings.[17]

21. At this stage of this dispute, Brazil does contend that it is challenging Canada's measures "as applied". Nowhere, however, has it specified the applications that it is challenging. Unlike *Export Restraints*, there is no question here of whether the mandatory/discretionary distinction is a jurisdictional issue. It is not. The question is what exactly Brazil is challenging.

22. As the European Communities noted, it is possible to challenge a programme "as such", or individual transactions under a programme "as applied" or even both. Both programmes and transactions may be the object of a claim in a panel request.[18] However, Brazil seems to be attempting to create a new class of case, the "open-ended 'as applied' case", in which the complainant asks the panel to figure out if there are applications that could be challenged. Brazil thereby seeks to relieve itself of its burden of proof and enlist the Panel as its prosecutor. In effect, Brazil has asked the panel to try to make its *prima facie* case for it.

III. THE FACTS AND THE LAW DO NOT SUPPORT BRAZIL'S AS SUCH CLAIMS

23. anada has described, Brazil's request for the establishment of a panel contains claims that Canada Account, "EDC" (Corporate Account) and Investissement Québec, "as such", are inconsistent with Articles 1 and 3 of the SCM Agreement. To prove these claims, Brazil bears the burden of showing that each of the three programmes, at least in some circumstances, makes it mandatory for Canada to grant prohibited export subsidies. Brazil has failed to meet this burden. Brazil cannot meet its burden because none of the three challenged programmes require Canada to grant prohibited exports subsidies.

A. CANADA ACCOUNT, CORPORATE ACCOUNT AND INVESTISSEMENT QUÉBEC ARE DISCRETIONARY

24. The facts are indisputable that each of the Canada Account, Corporate Account and Investissement Québec (or IQ) programmes has wide discretion as to whether, and on what terms, it will offer financing assistance. Nothing in the Export Development Act, the Investissement Québec Act or anywhere else, requires these programmes, when providing financing or financing assistance, to grant prohibited export subsidies.

25. In the case of Canada Account and Corporate Account, Brazil has failed to offer any compelling reasons – because there are none – for this Panel to reverse the findings of the DS 70 panel that these programmes involve discretionary rather than mandatory legislation and therefore, "as such", are not prohibited export subsidies.

26. In the case of IQ, which Brazil did not challenge in the DS 70 dispute, it is clear from the applicable legislation and regulations that the programme is discretionary, and in no circumstances requires Québec or Canada to grant prohibited export subsidies.

27. First, IQ generally, has broad discretion in the administration of its practices under the IQ Act. Second, Section 28 of the IQ Act, under which IQ can participate in regional aircraft transactions is also discretionary. It does not require IQ to act in a manner inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement.

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[17] WT/DS194/R, 29 June 2001, paras. 8.126, 8.130.
[18] Third Party Statement of the European Communities, 28 June 2001, para. 10.

28. Section 28 enables the Government of Québec to delegate to IQ the authority to determine and administer any assistance to be provided under Section 28. Section 28 provides that "the [IQ] mandate may authorize the agency to fix the terms and conditions of the assistance." It is obvious that "mandate" in this sense does not refer to what IQ must do, but to the scope of IQ's authority. It does not require IQ to authorize financing assistance under any specific terms and conditions, let alone on terms and conditions that would amount to a prohibited export subsidy.

29. In the case of assistance in regional aircraft transactions, the terms of IQ's mandate (i.e., the scope of its authority to act) under Section 28 are set out in the decrees filed as exhibits CDA-33 to 36. These decrees provide that IQ has broad discretion to accept or refuse to grant assistance in regional aircraft transactions. The decrees set out conditions that must be fulfilled in order for IQ to grant assistance and also specify that IQ can impose "any other conditions" for doing so.

30. Contrary to Brazil's argument, under Section 28 and the applicable decrees, IQ is never required to provide financing assistance in any regional aircraft transactions, and, if it does offer financing assistance, it is never required to confer a benefit thereby. The IQ programme therefore does not mandate the granting of prohibited subsidies. Brazil "as such" claim must fail.

B. BRAZIL'S ALTERNATIVE "AS SUCH" TEST IS BASELESS

31. Confronted with the indisputable fact that none of Canada's programmes make the granting of prohibited export subsidies mandatory, Brazil seeks to construct alternative tests for "as such" inconsistency out of whole cloth. Thus, Brazil argues that the Canada Account and Corporate Account programmes "as such" require the provision of export subsidies because they are export credit agencies "with the raison d'etre of providing export subsidies". This is factually incorrect. The raison d'etre of Canada's programmes is to provide financing assistance, not export subsidies. Brazil has no basis for its assertion.

32. Brazil attempts to argue that Item (k) exists as a recognition that all credits from export credit agencies are prohibited export subsidies, but this too is a baseless assertion. There is nothing in the SCM Agreement itself to support it. Nor does Brazil's position find support in the journal article that Brazil has cited in paragraph 45 of its second submission.

33. Brazil's argument is also legally incorrect. Brazil's position appears to be that the SCM Agreement prohibits all government export credits, except those offered in conformity with the second paragraph of Item (k). Article 1.1 of the SCM Agreement makes clear that financial contributions by a government, including such practices as loans or loan guarantees are not necessarily subsidies. To be subsidies, the financial contributions must confer a benefit. Brazil's argument would read out of existence Article 1.1(b) of the SCM Agreement as it relates to practices such as government loans and loan guarantees.

34. Not surprisingly, because it disregards the benefit element in Article 1, Brazil's position would have perverse results if accepted. Brazil argues, in effect, that an export credit agency may offer export credits only when they conform to the OECD Arrangement, but may not do so when they are on market terms. In other words, under Brazil's interpretation, export credits that do not confer a benefit and are not subsidies would be prohibited – an absurd result.

C. BRAZIL'S "GUARANTEES" EXAMPLE FAILS TO AID ITS CASE

35. Brazil also attempts to show that Canada's programmes are "as such" prohibited by arguing that the guarantees they may provide are necessarily prohibited export subsidies. Since none of Canada's programmes mandate the granting of guarantees, this argument cannot possibly demonstrate that the programmes are "as such" inconsistent.

36. Moreover, government guarantees are not necessarily subsidies at all. In its guarantee arguments, Brazil again seeks to avoid satisfying the second element of Article 1 of the SCM Agreement. According to Brazil, in the case of government guarantees, the mere existence of the financial contribution confers the benefit. Brazil's argument would conflate these two distinct elements of the definition of a subsidy.

37. In this respect, Brazil's argument regarding the transfer of a government's credit rating in favour of the purchaser or borrower misses the point. Any guarantee allows a borrower to obtain better rates or conditions than would be the case in absence of such a guarantee. This is true whether the guarantor is the government or a private financial institution.

38. To assess whether a benefit is conferred within the meaning of Article 1, one must look to whether the recipient is receiving the guarantee on terms more favourable than those available in the market. Brazil has failed to do this. Instead, Brazil seeks to reverse the burden of proof. For example, it contends in its second submission, at paragraph 52, that Canada has failed to demonstrate that the fees charged by EDC are commensurate with those charged by commercial guarantors. Brazil did the same thing this morning with respect to Investissement Québec. Brazil misses two points here. First, the initial burden lies on Brazil to show that Canada's guarantees confer a benefit; it is not Canada's burden to show that they do not. Second, to satisfy the "benefit" element of its "as such" case, Brazil would have to show that Canada's measures require conferral of a benefit, not that the measure could be used to confer a benefit.

39. As to Brazil's Item (j) argument, Brazil again ignores an essential element of the requirements in that provision. To be a "per se" prohibited subsidy under Item (j), a loan guarantee must be provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes". Brazil does not even attempt to demonstrate the existence of this requirement. For this reason alone, Brazil's argument must fail.

D. BRAZIL'S "FINANCIAL SERVICES" EXAMPLE FAILS TO AID ITS CASE

40. Brazil attempts to bolster its "as such" case against EDC (presumably Corporate Account) with the additional "example" of financial services. Brazil's argument seems to be that EDC's efforts in putting together financing packages should be regarded as distinct financial services. Brazil has never identified what precisely these services are, how they are distinct from the export credit practices it is challenging under Article 1.1(a)(1)(i), how they constitute a financial contribution or if they do constitute a financial contribution, how they thereby confer a benefit.

41. Insofar as these "services" seem to involve putting together a loan or guarantee deal, it is difficult to see how this is not covered by the granting of export credits under Article 1.1(a)(1)(i). Brazil argues that these EDC "services" confer a benefit because they are better than those offered by other financial institutions. However, Brazil has not explained how it would measure this alleged "benefit" other than the self-testimonials of agency officials. As Canada noted at paragraphs 82 and 83 of its first submission, Brazil has offered no evidence of the true test of a benefit: whether the "services" involved in providing a financial package are priced below market.

42. Finally, Brazil makes its services argument in the context of its "as such" claim. It therefore bears noting that Brazil has failed to show even a single case where the terms on which these "financial services" were offered were more favourable than those available in the market, let alone that they are necessarily offered on more favourable terms.

IV. THE FACTS AND THE LAW DO NOT SUPPORT BRAZIL'S "AS APPLIED" CHALLENGES

43. As Canada has explained, with the exception of the Air Wisconsin transaction, Brazil has failed to identify the specific transactions it is challenging when it argues that Canada's programmes have been applied inconsistently with the SCM Agreement. Air Wisconsin remains the only Canada Account transaction that Brazil is challenging. My colleague, Karl Blume, will address Brazil's Air Wisconsin arguments in a few minutes.

A. BRAZIL HAS FAILED TO DEMONSTRATE THAT ANY CORPORATE ACCOUNT TRANSACTION IS A PROHIBITED EXPORT SUBSIDY

44. In the case of Corporate Account, Brazil has focused on two transactions, ASA and Kendell. Brazil claims that both transactions involved prohibited export subsidies, but in neither case has Brazil demonstrated, as it is required to do, that Corporate Account financing was provided on terms more favourable than those available to the recipient in the market and therefore conferred a benefit. Brazil has failed to make out a *prima facie* case. Nevertheless, at the request of the Panel, in its response to Question 45, Canada has presented evidence and argument proving that these transactions did not confer a benefit within the meaning of Article 1 of the SCM Agreement. In fact, Canada's answer demonstrates that the interest rate given to ASA is within the range of rates that could have been obtained in the market for a similar transaction.

45. In its responses to the Panel's Question 50, Brazil makes two objections to Canada's evidence regarding ASA. First, Brazil states, with respect to the risk premium, that: "Presumably, a small airline such as ASA would have a higher credit risk than US Air or Northwest". Brazil offers no basis for this presumption, which is demonstrably incorrect. Brazil reiterated this presumption today. An airline's credit-worthiness is a function of its financial performance, not its size, as the failure of large airlines such as Pan American illustrates. For instance, Southwest, one of the smaller major US airlines, has a better credit rating than any other major US airline. Brazil has confirmed this. Itnotes that Southwest has a higher rating than, for example, British Airways, which is one of the largest airlines in the world.

46. Second, Brazil argues that the lack of [] identified in the offer to [] "appears" to illustrate how the transaction was on below-market terms. In fact, the absence of any []. The test of market pricing, as in the case in question, is the "all-in" cost of the financing to the borrower.

47. In the case of Kendell, as Canada has described in its discussion of burden of proof, Canada has provided evidence that the terms of the offer were identical to those of seven commercial banks participating in the transaction. Brazil's only response has been to make unsubstantiated allegations and suppositions and to ask the Panel to insist on further evidence from Canada.

48. Canada does not expect that the Panel will take Brazil up on its request. Nor should the Panel do so. Nevertheless, in the interest of fully refuting Brazil's charges, Canada offers the following responses.

49. First, the number of commercial banks participating was indeed seven. In a syndicated deal such as the Kendell transaction, many banks are invited to participate. At the time EDC prepared its pricing strategy, it knew of four banks that were participants. Three others also joined. In its answer to Question 11, Canada listed all seven banks but inadvertently counted them as five.

50. Second, Brazil contests the accuracy of Canada's statement that EDC participated on an equal risk-sharing basis. EDC participated on what is known as a "pari passu" basis. This means that it was equally exposed to the risk of non-payment of its loan and that it participated in the loan on the same

terms and conditions as the other commercial lenders. EDC was responsible for [] per cent, not [] per cent of the lending provided.

51. Third, the comparisons Brazil seeks to draw between other spreads and those offered to Kendell are irrelevant in the face of proof that EDC's financing to Kendell was on terms no more favourable than those available in the market. This is very interesting given the allegation Brazil has made this morning about appropriate market spreads. In fact, Kendell recently completed a second round of financing for [] more CRJ-200 aircraft. That financing was offered by a group of four commercial banks. According to a news report in Airfinance Journal, (exhibit CDA-66), those banks priced the senior tranche of debt to Kendell at Libor plus 70 basis points. That is, it was priced [] basis points below the financing in which EDC was involved. If one looks at Brazil's exhibits 65 and 66, the latter in particular states that the market spread for Kendell financing should be [] basis points. This calls into serious question the reliability of the assumptions and data in Brazil's new exhibits. Brazil cannot deny what was available to Kendell in the market. Brazil seems to be suggesting that commercial banks are wrong when their pricing differs from what Brazil thinks it should be.

52. Brazil also makes the unsubstantiated assertion that the terms set for the first Kendell transaction were "influenced by EDC's participation". EDC's participation had no influence on the terms, as evidenced by the second, lower-priced, Kendell financing, in which EDC did not participate.

53. One essential point remains true of both the Kendell and ASA transactions as well as every other Corporate Account transaction that Brazil has mentioned in its submissions: in no instance has Brazil established a *prima facie* case that Corporate Account financing is provided on terms more favourable than those available to the recipient in the market. That is, in no instance has Brazil demonstrated the existence of a benefit. The Panel must dismiss these "as applied" challenges, whichever they may be.

B. BRAZIL HAS FAILED TO DEMONSTRATE THAT ANY IQ TRANSACTION IS A PROHIBITED SUBSIDY

54. Brazil's "as applied" challenge to Investissement Québec seems to be limited to the assertion that IQ has, in specific transactions, provided guarantees that are allegedly prohibited export subsidies. However, Brazil has failed to establish that any such transactions either confer a benefit or are contingent upon export performance.

1. IQ Assistance Does Not Confer a Benefit

55. The arguments and evidence submitted by Canada in response to Question 47 of the Panel clearly demonstrate that IQ charges market fees for its guarantees. Brazil has not, at any point in this dispute, demonstrated the existence of a benefit in respect of any IQ transaction. Brazil's "as applied" arguments therefore fail.

2. IQ's Assistance Is Not Contingent Upon Export Performance

56. Even if the Panel were to accept Brazil's unsubstantiated argument that IQ has granted a subsidy in specific transactions, Brazil claims would still fail because Brazil has not established that the provision of IQ assistance is contingent upon export performance. Brazil has failed to identify any legal instrument establishing the export contingency of IQ. It has also failed to submit evidence establishing that IQ's assistance is, in fact, contingent upon export performance.

57. Neither the IQ Act nor any of the relevant decrees demonstrate any element of export contingency attached to the various forms of IQ's financial assistance. Accordingly, export

contingency cannot be established on the basis of the words of the relevant legal instruments. Nor has Brazil offered any evidence that export performance was a condition for the provision of the assistance in any IQ transaction.

58. Brazil's principal argument that IQ assistance is export contingent appears to be that it "suspects" that there is a more recent version of the "critères d'évaluation" used by IQ to authorize the granting of guarantees, which would establish that IQ's support is contingent upon export performance. That Brazil felt compelled to ask the Panel to seek additional information from Canada on this issue indicates that Brazil is well aware that it cannot establish *de jure* export contingency on the basis of the "critères d'évaluation" and the legal instruments. As Canada mentioned in its response to question 42 from the Panel, there is no updated version of the "critères d'évaluation" and no other guidelines that exist. Clearly, in law, export performance is not a criterion that can be taken into account by IQ when it provides guarantees.

59. Finally, in its rebuttal submission, Brazil alleges (for the first time) that IQ guarantees are also *de facto* contingent upon export performance. Brazil's only argument in support of its allegation is that Canada is aware that its domestic market cannot absorb Bombardier's production of regional aircraft and that the panel in *Australia – Automotive Leather* established that "a Member's awareness that its domestic market is too small too absorb domestic production of a subsidized product indicates the subsidy is granted on the condition that it be exported."[19]

60. Brazil's reference to the panel's finding in *Australia-Leather* is both inaccurate and taken out of context. Brazil implies incorrectly that the *Australia – Leather* panel consider a member's awareness that its market could not absorb subsidized domestic production to be sufficient to prove *de facto* export contingency. In fact, the subsidy in *Australia-Leather* was, conditioned in part on sales performance targets. Given that the Australian government was aware of the fact that the recipient of the subsidy would have to maintain or increase export sales in order to meet the sales performance targets, the panel considered that, in fact, sales performance targets were export performance targets. Those specific circumstances of the case led the Panel to find that there was, in fact, a close tie between anticipated exportation and the grant of the subsidies.[20]

61. Moreover, Brazil has failed to apply the test established in *Canada-Aircraft I* for the purpose of determining whether a subsidy is contingent, in fact, upon export performance. In *Canada – Aircraft I*, the Appellate Body established that in order for a subsidy to be contingent in fact upon export performance, it must be "tied to" export performance. The Appellate Body found that the ordinary meaning of "tied to" necessarily implies a relationship of "conditionality or dependence" between the provision of the subsidy and export performance. The Appellate Body specifically stated, at paragraph 171 of its Report, that it is not sufficient for a complainant to "demonstrate solely that a government granting a subsidy anticipated that exports would result".

62. The Appellate Body also found that footnote 4 of the SCM Agreement precludes a Panel from making a finding of *de facto* export contingency for the sole reason that the subsidy is "granted to enterprises which export".[21] It appears that Brazil has chosen to ignore the test elaborated by the Appellate Body because its only argument remains Canada's "knowledge" of the export propensity of the Canadian regional aircraft industry. Clearly, this is not sufficient to demonstrate *de facto* export contingency. Brazil has not submitted any other evidence demonstrating that the provision of IQ guarantees is conditioned or dependent on export performance. Therefore, its *de facto* argument must also fail.

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[19] Second Submission of Brazil, 13 July 2001, para. 149.
[20] *Australia – Leather*, Panel Report, para. 9.67.
[21] WT/DS70/AB/R, para. 173.

C. BRAZIL HAS FAILED TO DEMONSTRATE THAT THE AIR WISCONSIN TRANSACTION IS A PROHIBITED SUBSIDY

1. Canada's Offer On A Matching Basis In Response To Brazil's Offer To Air Wisconsin Is Consistent With The SCM Agreement

63 Canada considers that Embraer's offer involved, and indeed could not have been made without, Brazilian government support. The Air Wisconsin transaction is consistent with Canada's SCM Agreement obligations because Canada is merely matching Brazil's offer in a manner consistent with the "interest rates provisions" of the Arrangement. Canada's offer therefore qualifies for the "safe haven" of the second paragraph of Item (k) to Annex I to the SCM Agreement.

64 If, however, as Brazil contends, commercial credit was available to Air Wisconsin on the terms Embraer offered to arrange, those terms would be, by definition, available in the market. Canada's offer is on terms no more favourable than those Embraer offered to arrange and therefore no more favourable than those available to Air Wisconsin in the market. Accordingly, Canada's offer would not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement.

65 [] Although Canada does not consider the latter possiblity to have been plausible, Brazil cannot have it both ways. Brazil cannot argue that Embraer's offer did not involve Brazilian official support and at the same time argue that Embraer's offer did not constitute terms and conditions available to Air Wisconsin in the market.

(i) The SCM Agreement Permits Canada's Offer on a Matching Basis in Response to Brazil's Offer to Air Wisconsin

66. In its Rebuttal Submission and in its response to the Panel's Question 52, Brazil put forth three arguments on why Canada's offer to Air Wisconsin on a matching basis is inconsistent with the SCM Agreement. Brazil's first argument is that its offer to Air Wisconsin did not involve Brazilian official support. Second, Brazil argues that, if Brazilian official support was involved, Canada's offer was more favourable than Brazil's offer. Third, Brazil claims that matching is not in conformity with the "interest rates provisions" of the Arrangement. Canada refuted each of these arguments in previous submissions. Canada's comments today will focus on the inconsistencies and illogic of Brazil's arguments.

(a) Embraer's Offer to Air Wisconsin Involved Brazilian Official Support

67. With respect to its first argument, Brazil claims that Embraer's offer to Air Wisconsin did not involve Brazilian official support. At a minimum, Brazil or Embraer led Air Wisconsin to believe that Brazilian official support would be provided. Canada suggests that the only reasonable inference was that Brazilian official support was involved in Embraer's offer to Air Wisconsin.

68. It is not credible that [].

69. Embraer by its own admission continues to rely heavily on official support from Brazil. According to Embraer, without Brazilian official support Embraer's "cost-competitiveness" could decrease. Brazilian official support – now and in the future – impacts substantially on Embraer. [22] Embraer could not have made its offer without Brazilian official support.

(b) Canada's Offer was Made on a Matching Basis

[22] Embraer's 1998-2000 Financial Statements, note 32 (Exhibit CDA-57).

70. Brazil's second argument is that, if Brazilian official support was involved, Canada's offer was more favourable than Brazil's offer. In Canada's response to the Panel's Question 46, Canada explained how its financing offer to Air Wisconsin was on a non-identical matching basis and was no more favourable than Brazil's offer. Non-identical matching is permitted by the OECD Arrangement, both because a matching Participant may have imperfect information about the offer being matched and because different export credit agencies use different instruments to provide export credits.

71. Brazil attempts to explain away the fact that Canada's offer was no more favourable than Brazil's offer by excluding from the comparison a "special element" of its offer which Brazil claims is unrelated to financing.[23] However, this "special element" is indeed related to financing. In Brazil's letter to the Panel of 25 June, this [].

72. Brazil makes a secondary argument that Canada did not comply with Article 53 of the Arrangement. Canada carried out its due diligence and matched the Brazilian offer in good faith.

73. Canada's response to the Panel's Question 46 included a reference to the due diligence efforts that it took to ensure that its financing offer matched Brazil's financing offer. As Embraer's term sheet demonstrates, these efforts succeeded. Canada's due diligence included an extensive discussion with Air Wisconsin officials. From the responses of Air Wisconsin, Canada concluded that the Embraer offer involved Brazilian government export financing support [].

74. Air Wisconsin's responses also corroborated previous statements by Brazilian officials, including Brazil's then Foreign Relations Minister, Luiz Felipe Lampreia, who stated, with respect to PROEX, that: "[f]or us, the interest rate is [the] OECD rate, the coverage is 100 per cent and there are no limits on the length of the terms."[24] Mr. Lampreia, although no longer the Foreign Relations Minister, is now a member of Embraer's Board of Directors. He is one of two Brazilian Government representatives that sit on Embraer's Board.[25]

(c) Matching is in Conformity with the "Interest Rates Provisions" of the Arrangement

75. Brazil's third argument is that matching is not in conformity with the "interest rates provisions" of the Arrangement. Brazil refers the Panel to its response to the Panel's Question 36. Brazil's response to Question 36 does not address Canada's arguments. Canada has repeatedly demonstrated that:

- Matching is specifically "permitted" by, and in conformity with, the provisions of the Arrangement;

- The substantive provisions in the Arrangement that determine what interest rates are permitted, and that affect what the interest rate and the amount of interest will be, in a given transaction, but excluding procedural requirements with which a non-Participant inherently could not comply, are logically "interest rates provisions". Matching provides one alternative permitted way of determining an interest rate and is consistent with the Arrangement. Therefore, matching is an "interest rates provision";

- Accordingly, matching is in "conformity" with the "interest rates provisions" of the Arrangement;

- Matching is consistent with the object and purpose of the SCM Agreement; and

[23] Second Submission of Brazil, para. 91 and Brazil's Response to the Panel's Question 52, last paragraph.
[24] Exhibit CDA-6.
[25] Exhibit CDA-67, pp. 66 and 73.

- The application of matching is not de facto more favourable treatment for WTO Members that are Participants in the Arrangement vis-à-vis WTO Members that are non-Participants because matching is available to all WTO Members.[26]

76. In conclusion, Embraer's offer to Air Wisconsin involved Brazilian official support. Canada's offer was on a matching basis and was no more favourable than Brazil's offer to Air Wisconsin. Furthermore, Canada's offer was made in good faith and on the basis of reasonable due diligence in response to Brazil's offer to Air Wisconsin. Finally, matching is in conformity with the "interest rates provisions" of the Arrangement. Therefore, because Canada is merely matching Brazil's offer in a manner consistent with the "interest rates provisions" of the Arrangement, Canada's offer qualifies for the "safe haven" of the second paragraph of Item (k) to Annex I to the SCM Agreement.

(ii) If Embraer's Offer did not contain Brazilian Official Support, Canada's Offer was on Terms No More Favourable Than Those Available to Air Wisconsin in the Market

77. Alternatively, if the Panel were to accept Brazil's position that commercial credit was available to Air Wisconsin on the terms Embraer offered to arrange without Brazilian government involvement, those terms would be, by definition, available in the market. It would be Brazil's burden to establish a *prima facie* case that Canada's offer was more favourable than Embraer's offer to Air Wisconsin. Brazil cannot do so. As Canada explained in its answer to the Panel's Question 46, its offer to Air Wisconsin is no more favourable than that which Embraer offered to arrange according to its term sheet. Canada's offer therefore is on terms no more favourable than those available to Air Wisconsin in the market. Accordingly, Canada's offer would not confer a benefit within the meaning of Article 1.1(b) of the SCM Agreement. Brazil's claims must fail.

V. CONCLUSION

78. Mr. Chairman, there's an old saying among lawyers, that I'm sure will be familiar to counsel for Brazil: "When the facts are against you, argue the law; when the law is against you, argue the facts; when both the facts and the law are against you, pound on the table."

79. Because the facts and the law are extremely unhelpful to its claims, Brazil has done its share of table pounding in this dispute. However, in the course of its submissions it has adopted other tactics more worthy of the Panel's attention. It has sought to avoid its burden of proof and it has avoided and misrepresented the facts and the law.

80. The panel must not permit this. It cannot, for example, allow Brazil's deficient claims to stand. It cannot allow Brazil to make open-ended claims and enlist the Panel as its prosecutor. It cannot allow Brazil to evade the well-established test for "as such" inconsistency, nor to pretend that Canada's programmes are anything but discretionary. It cannot allow Brazil to avoid the Appellate Body's test for the existence of a benefit by arguing that all government export credits are "as such" prohibited export subsidies or that Canada's transactions are illegal because they do not conform to the OECD Arrangement. It cannot allow Brazil to have it both ways on the Air Wisconsin transaction.

[26] Canada's First Submission, paras. 51–60; Canada's Oral Statement 27 July 2001, paras. 22–40; and Canada's Rebuttal Submission, paras. 74–78.

81. Mr. Chairman, distinguished members of the Panel, Brazil has sought to avoid its burden of proof, the correct legal tests and facts themselves, because it is apparent that when the appropriate legal standards are applied to the facts of this dispute, none of Brazil's claims can be sustained. Accordingly, Canada respectfully requests that all of Brazil's claims be dismissed.

82. I thank you for your patience and attention.

ANNEX B-11

RESPONSES OF CANADA TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(8 August 2001)

Following are Canada's answers to the Panel's questions.

Questions to Both Parties

Question 54

In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

1. In the field of regional aircraft financing it is entirely possible that there may be several commercial transactions at a range of prices. Several commercial transactions may be with the same or similar borrowers. The specific price that a financial institution will typically offer will depend on that institution's assessment of a range of variables, including the creditworthiness of the purchaser, security, the size of the transaction, any precedents in respect of the same or similar borrowers, the term of the financing, the loan-to-value ratio, the existence and nature of any guarantees and the commercial appetite of the institution for the business. Indeed, the Appellate Body recognized that "the commercial interest rate with respect to a loan in a given currency varies according to the length of maturity as well as the creditworthiness of the borrower."[1] As far as the creditworthiness of a purchaser is concerned, in the absence of any public benchmark, a financial institution would use other assessment tools to establish a commercially sound benchmark for that particular borrower.

2. A "market price" can be determined, at least in part, by examining what the relevant borrower has recently paid in the market for *similar terms* and with *similar security*. Commercial transactions that feature different terms and conditions or different security, or that occurred in a different time period, are less relevant. Due to the range of variables, one will probably not be able to determine a precise, single "market price". Several transactions involving similar credit qualities, similar terms and similar security over a period of time leading up to the conclusion of the transaction may enable one to identify a range of prices that would be at "market". Moreover, different commercial financial institutions may price a transaction somewhat differently, even if the terms and security are the same, based, *inter alia*, on their familiarity with the borrower, the security and/or the sector. If it were otherwise, there would be no "market".

[1] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 182 [hereinafter "*Canada – Aircraft I*, Appellate Body Report"].

Question 55

If it is commercial practice to engage in transactions at a short-term loss for long-term commercial reasons, should such transactions be treated as "market" transactions? Please explain.

1. []. There is no evidence whatsoever to support this speculation. Moreover, Brazil's unsubstantiated speculation has been contradicted by:

2. [];

3. Embraer's recent Form 20-F filing with the US Securities and Exchange Commission (SEC) which states that Embraer does not provide direct financing to its customers (Exhibit CDA-69); and

4. Brazil's own representative, Mr. Azevedo, who acknowledged at the second meeting of the parties that aircraft manufacturers do not normally engage in such tactics because of the danger that subsequent customers would demand similar discounts.

5. As Canada describes in its answer to the Panel's Question 67, *all* of the evidence regarding Embraer's offer indicates that it did involve Brazilian government support and [].

6. However, as a hypothetical matter, a commercial transaction at a short-term loss for long-term commercial reasons should be considered as a "market transaction". Whether the commercial offer is influenced by a given pricing or marketing strategy does not change the fact that a private commercial party was willing to make a financing offer on those terms to that recipient. In that sense, the financing terms and conditions were terms and conditions available to the recipient in the "market".

Question 56

Please analyse the significant elements of Embraer's second offer, and the Canada Account / Bombardier offer, to Air Wisconsin, and indicate how the significant elements demonstrate that such offers were, or were not, comparable.

1. The following compares those elements that Canada considers "significant" and that are contained in both the Canadian and Brazilian offers. However, there are also numerous elements, some of which could be considered "significant", for which no provision has been made in the Embraer offer. Although one would reasonably expect that Embraer would have provided for at least some of these elements, in the absence of any explicit reference to them in the Embraer offer it is not possible to compare them.

1. Number of Aircraft

Canada's offer provides for support for [].

Embraer's offer provides for support for [].

In the Article 22.6 arbitration in *Brazil – Aircraft*, the arbitrators assumed a conversion of options into firm orders at a rate of [].[2] Applying the same conversion rate to [].

[2] *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*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000, para. 3.79.

2. Financed Amount:

Canada's offer provides for financing up to [] aircraft.

Brazil's offer provides for [].

3. Repayment Term:

Canada offered a repayment term of [] with maximum average life of [].

In respect of [].

4. Interest Rate:

Canada offered an interest rate of [] in effect at the time of delivery of each aircraft.

[]

5. Administration Fee:

Canada's offer requires payment of an up-front administration fee [] per cent of the financed amount payable at the time of financing of each aircraft.

[]

6. Security:

Canada's offer requires, *inter alia*, a first perfected security interest in the aircraft, assignment of insurance and manufacturer's warranties.

[]

It is reasonable to expect that had the sale materialized for Embraer, such provisions would have been incorporated in final loan agreements and would have been comparable to those included in Canada's offer. However, the absence of one or more of these provisions in Embraer's offer would render Embraer's offer more favourable to Air Wisconsin.

7. Other Financing Support:

[]

Based on the foregoing, and the assumption that Embraer would ultimately provide terms at least equally restrictive as Canada's for those provisions not specifically addressed in its offer, Canada concludes that Canada's financing offer was not more favorable to Air Wisconsin than Embraer's. This is also the judgement of the purchaser, as reconfirmed in Air Wisconsin's letter of 7 August 2001 (Exhibit CDA-68).

Questions to Canada

Question 63.

What is the legal status of the EDC Credit Risk Policy manual (Exhibit CDA-48)? Is it legally binding on the EDC?

1. EDC's Credit Risk Policy Manual is a set of credit risk management policies that was developed with the assistance of Oliver, Wyman & Co., a management consulting firm with expertise in the banking sector, including active portfolio management and pricing for credit assets. The manual was developed as part of EDC's continuous review of processes and systems in order to improve the administration and assessment of credit risk under EDC's contingent liability and lending programmes. It represents the various components of EDC's risk management structure for transactions under these programmes and is part of EDC's commitment to ensure that its policies for the assessment of credit risks under proposed transactions and the management of its portfolio of transactions embody relevant best-in-class practices within the private sector and the public sector.

2. As a self-governing, autonomous Crown corporation, EDC's operating practices and policies are the responsibility of its Board of Directors. The Credit Risk Policy Manual was approved by the Board of Directors, but it is not legislation and consequently is not binding on EDC in the same way as legislation would be. However, any transaction of EDC which is within the authority delegated to EDC management and which departs from the policies in the Manual is not duly authorized unless the transaction is in accordance with an exception to the relevant policy (as approved by the Board of Directors) or the Board approves the transaction itself.

Question 64

What is the legal status of the Government Response to the Standing Committee on Foreign Affairs and International Trade (Exhibit BRA-28)? Is it legally binding on the EDC?

1. Section 25 of the *Export Development Act* (the "Act") provides that the Minister for International Trade (the "Minister") will periodically cause a review of the provisions and operation of the Act to be undertaken. The first such review commenced in 1998. Subsequent reviews must be undertaken every ten years. The review report was submitted to the Parliament of Canada and referred to a standing committee of the House of Commons (the Standing Committee on Foreign Affairs and International Trade – "SCFAIT"). The SCFAIT made several recommendations when it reported to the House of Commons. The Government's Response to the SCFAIT report (Exhibit BRA-28) is the Government's report to the House of Commons regarding legislative and non-legislative actions being taken in response to the SCFAIT report and recommendations. These actions are underway.

2. The Government's Response is not legally binding on EDC. However, the legislative actions (proposed amendments to the Act) will, when passed, be legally binding on EDC. Furthermore, with respect to the non-legislative action, the Minister has instruments at his disposal (such as the issuance of directives and the approval of EDC's annual corporate plan) through which he can legally require EDC to conform to non-legislative measures that he finds necessary and appropriate.

Question 65

With reference to Exhibit CDA-66, what is a "letter of awareness"?

1. Exhibit CDA-66 is a published article on the second Kendell transaction in which, as stated previously, EDC was not involved. Canada, therefore, cannot comment on the specific letter referred to in that article, but can provide the following definitions:

LETTER OF AWARENESS:

> A formal letter written by a parent company to a lender, acknowledging its relationship with another group company and its awareness of a loan being made to that company. It is [the] weakest form of a letter of comfort.[3]
>
> LETTER OF COMFORT:
>
> A letter to a bank from the parent company of a subsidiary that is trying to borrow money from the bank. The letter gives no guarantee for the repayment of the projected loan but offers the bank the comfort of knowing that the subsidiary has made the parent company aware of its intention to borrow; the parent also usually supports the application, giving, at least, an assurance that it intends that the subsidiary should remain in business and that it will give notice of any relevant change of ownership. Se also letter of awareness.[4]

Question 66

Has the LA Encore programme used by the EDC been adapted for specific EDC considerations, or is it identical to the programme used by Lloyds Bank, Barclays Bank, and ABN-Amro?

1. FAMAS/- LA Encore is a computer-based company analysis software developed by a Certified Public Accounting firm and systems analyst company as a tool for analyzing financial risk and comparing, on a broad basis, the financial risks associated with different companies. The larger the database of companies, the greater the consistency of the rating with that of other companies in the industry. As previously noted by Canada, FAMAS/- LA Encore is now owned by Moody's Risk Management Services, one of the two largest rating agencies in the world. (As a result, the LA Encore software has been renamed Moody's Risk Advisor, or MRA).

2. One of the purposes of using such a tool is to generate ratings for companies that are not publicly rated by a rating agency and that are consistent with the ratings that are provided by such agencies.

3. Rating agencies, such as Moody's and Standard and Poor's, provide ratings at the request of the company being rated. The company must pay to obtain a rating. Companies are willing to make this expenditure when they intend to seek financing in the public debt markets. The fact that a company is not publicly rated is not necessarily an indicator of any financial weakness or defect nor is it an indicator of the size of the company; it simply indicates that the company does not require public debt financing. A lender must have an alternative method of assessing the financial risk of unrated companies that seek its financing.

4. Moody's maintains each user's system to ensure consistency with the public ratings that it publishes. Moody's permits LA Encore to be tailored using customization tools to establish or reflect an organization's own credit practices, policy guidelines or internal ratings approach based on its own lending preferences and portfolio.

5. The EDC has utilized the customization features of LA Encore to reflect EDC's own corporate risk methodologies. This recalibration of specific weightings has been undertaken to ensure all EDC generated ratings take into account a data-base of the current senior unsecured bond ratings

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[3] *A Dictionary of Accounting*, (Oxford: University Press, 1999) ("Letter of Awareness"), available online at www.xrefer.com. (Exhibit CDA-70).

[4] *A Dictionary of Accounting*, (Oxford: Oxford University Press, 1999) ("Letter of Comfort"), available online at www.xrefer.com. (Exhibit CDA-71)

of more than 900 S&P rated industrials. This allows EDC to calibrate its own internally generated ratings with these external market benchmarks. EDC's risk rating methodologies, which include the recalibration, have been reviewed in the context of EDC's credit risk management framework[5] by the external risk management consultants Erisk. Erisk has deemed these methodologies to be in line with standard industry practice.

6. Canada cannot comment on the customizations that may have been undertaken by other financial institutions that use LA Encore. Nevertheless, the systems they purchased from the vendor would be the same as that purchased by EDC.

7. Canada has submitted as Exhibit CDA-72 a brochure further describing the LA Encore system and as Exhibit CDA-73 a recent Moody's research report on Moody's Risk Advisor which specifically discusses the use of knowledge-based systems in the context of commercial lending.

Question 67

With reference to paragraph 5 of Canada's oral statement of 31 July 2001, please identify the "strong evidence" of Brazilian Government support for Embraer's offers to Air Wisconsin.

1. []

2. []

3. However, it is simply not credible that [].

4. In addition to the term sheet itself, the evidence that Embraer's offer was predicated on Brazilian government support is:

- The [] declaration and contact report (Confidential Exhibit CDA-1), consisting of a declaration and an [], this exhibit shows that at the time Embraer's offer was made, Air Wisconsin understood that it involved Brazilian government support.

- A new letter, provided by Air Wisconsin (Exhibit CDA-68), stating that "[]."

- Similar offers of government support made by Brazil at about the same time in the context of campaigns for the sale of regional aircraft to SA Airlink, a South African airline and Japan Air Systems.[6]

- []. The CIRR is the rate specified in the OECD Arrangement for purposes of official support. It is not a rate normally used for commercial offers, which refer to benchmarks such as US Treasury rates or LIBOR plus a spread to reflect credit risk. In a commercially financed transaction, negotiations with the purchaser would focus on the spread until an appropriate spread was agreed upon.

- At the time Embraer made its offer, Brazil took the position that offers of PROEX-supported financing down to the CIRR rate alone would be consistent with Article 3 of the SCM Agreement whether or not they satisfied the other "interest rates" provisions of the OECD Arrangement. Thus, Brazil's then Foreign Minister Lampreia, who now sits

[5] See Exhibit CDA-48, p. 16.
[6] Confidential Exhibits CDA-4 and CDA-5.

on Embraer's Board of Directors,[7] stated with respect to PROEX, that "[f]or us, the interest rate is [the] OECD rate, the coverage is 100 per cent and there are no limits on the length of the terms."[8] []

- Note 32 to Embraer's most recent financial statements (Exhibit CDA-57) makes clear that Embraer continues to rely heavily on Brazilian government support. According to Embraer, without Brazilian government support, Embraer's "cost-competitiveness" could decrease. The same note 32 refers to PROEX payments decreasing the effective interest rate to the "commercial interest reference rate", that is, the CIRR.

- In a response to a question from the panel in the PROEX III proceeding, Brazil stated that:

  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. … PROEX payments enable Embraer to avoid a competitive disadvantage *in the marketplace* by enabling it to offer financing *at the CIRR and market rates*. ….[9] [emphasis added]

5. Brazil has not explained why Embraer's offer to Air Wisconsin would have been any different than the practice it described in the PROEX III proceeding.

6. Brazil has stated that Embraer's offer to Air Wisconsin could have been "on its own account" and has speculated that []. Brazil has offered no evidence whatsoever for this proposition, nor has it explained what the long-term gain may have been. On the contrary, on 31 July, Brazil's representative at the second meeting of the parties acknowledged that aircraft manufacturers do not normally engage in deep discounting because of the danger that subsequent customers would demand similar discounts.

7. Most important, Brazil's suggestion that [] offer is directly contradicted by Embraer's 2 July 2001 Form 20-F filing with the SEC. In that filing, Embraer states:

> We do not provide direct financing to our customers. We assist our customers in obtaining financing arrangements through different sources such as leasing arrangements and the BNDES-*exim* programme. In addition, we help our customers qualify for the ProEx programme.[10]

8. []. According to its SEC filing, Embraer does arrange this, through BNDES-*exim* credits and/or PROEX.

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[7] Embraer, Securities and Exchange Commission Form 20-F, p. 66. (Exhibit CDA-67)

[8] M.L. Abbott, "Parceria da Bombardier no país não altera negociação com Canadá" ("Bombardier's partnership in the country does not change negotiations with Canada") *Valor Econômico* (30 October 2000). (Exhibit CDA-6)

[9] See Brazil's Response to the Panel's Question 4, *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, not yet adopted, p. B-50.

[10] Exhibit CDA-69, p. 34.

9. This conclusion is supported by Air Wisconsin's letter, [], Brazil's contemporaneous practice in other transactions, [], which correspond with Brazil's then position regarding official support terms, statements by Embraer in its SEC filings regarding its dependence on Brazilian government support, and a similar statement in the PROEX III proceedings in which Brazil described how Embraer generally does business with "some form of official government support for export credits."

10. By contrast, Brazil has offered no evidence whatsoever for its speculation that [] and Brazil's suggestion has been contradicted by, among other things, the Air Wisconsin letter and Embraer's own statements to the SEC. The only reasonable conclusion from the evidence before the Panel is that Embraer's offer involved Brazilian government support.

Question 68

11. Article 25 of the IQ Act refers to "export" activities. Is the term "export" defined in the IQ Act, or in some other legislative instrument? If so, please provide the relevant material. Does the term "export" mean export outside of Québec, export outside of Canada, or both?

12. The term "export" is not defined in the IQ Act or in another legislative instrument. However, in keeping with the jurisdiction of the IQ Act, which is limited to the territory of Québec, the term "export" as used in the Act is considered by IQ and Québec officials to refer to exports outside of Québec, which could include exports outside of Canada. Consistent with this interpretation, section 2 of Decree 572-2000 (Exhibit BRA-19), which was made pursuant to the IQ Act, defines "export" as:

> « la vente de biens, la prestation de services et l'exécution de contrats à l'extérieur du Québec; »

2. Generally speaking, when the term "export" is used in Québec legislation, it is used to mean exports outside of Québec and not necessarily outside of Canada. For example, the *Loi sur l'exportation de l'électricité* (L.R.Q., c. E-23), does not define "export" but has been applied consistently to exportation outside of Québec.

Question 69

Could IQ Decrees 572-2000 and 841-2000 apply in principle to financing regarding sales of Bombardier regional aircraft?

1. Decree 841-2000 could not apply to financing of Bombardier regional aircraft because it applies only to small enterprises. Bombardier would not qualify. Decree 572-2000 applies, for the most part, to investments in Québec. However, one of the measures in the Decree provides for loan guarantees intended for buyers outside of Québec for the purchase of goods and services. Such loan guarantees cannot exceed 75 per cent of the Québec content of the products included in the transaction. Theoretically, this measure could be used to finance the sale of Bombardier regional aircraft. However, due to the Québec content limitation and other restrictions, Decree 572-2000 is not well suited to financing regional aircraft sales and has never been used to do so.

Question 70

Canada has informed the Panel that equity guarantees have been provided by engine manufacturers such as Rolls-Royce, GE, and Pratt & Whitney. Is Canada aware of other instances where equity guarantees have been provided in respect of aircraft transactions? For example, are EETCs packaged with equity guarantees? If there is no market for equity guarantees outside of IQ and engine manufacturers, how should the Panel determine whether or not the equity guarantees provided by IQ confer a benefit? Is Article 14(c) of the SCM Agreement relevant in this regard?

(i) Is Canada aware of other instances where equity guarantees have been provided in respect of aircraft transactions?

1. Contrary to Brazil's general allegations, there is clear evidence of the existence of a private sector market for the transfer of risk in a manner similar to the guarantees provided by IQ. IQ provides "equity guarantees" or "deficiency guarantees" that cover the first level of risk assumed by a financial institution. This level of risk is commonly referred to as the "equity risk". Financial instruments similar to IQ equity guarantees are, in fact, available in the market.

2. Furthermore, Canada notes that the letters submitted by Brazil in support of its allegation that such guarantees would not be "economic" do not take into account the specific characteristics of the mechanisms used by IQ, []. These mechanisms are essential to making the IQ guarantees "economic" from a commercial point of view.

3. Exhibit CDA-74 demonstrates that Bombardier has, in fact, used private sector alternatives in precisely the same manner as IQ. []

4. Not only is this transaction analagous in structure to IQ guarantees, []. This has the effect of substantially lowering the risk assumed by the insurer (IQ).

5. Exhibit CDA-75 shows that aircraft manufacturers can create innovative financing mechanisms centred around risk and remuneration. []

6. This innovative structure shares many of common elements of the IQ model: the assessment of the risk of a default (based on the credit-worthiness of the operator of the asset), the assessment of changes in the market environment, the assessment of changes in the underlying value of the assets, and their repossession, refurbishment, remarketing costs. In this case, the private-sector insurance syndicate [] provided the guarantee in exchange for an up-front fee that would, in its estimation, cover its risk.

7. Moreover, Exhibit CDA-76, which contains letters from two respected financial services institutions, indicate that there is an active private sector market for "risk transfer", the technical term for transactions of this kind. The letters indicate that the private sector is not only capable of analyzing the risk and determining the appropriate fee to guarantee the risk, but is also ready to assume the risk of a portion of debt or equity in aircraft financing transactions in case of default.

(ii) Are EETCs packaged with equity guarantees?

8. No, EETCs are not packaged with equity guarantees. EETCs are instruments that are associated with debt financing, whereas "equity guarantees" are instruments that facilitate raising equity.

(iii) If there is no market for equity guarantees outside of IQ and engine manufacturers, how should the Panel determine whether or not the equity guarantees provided by IQ confer a benefit? Is Article 14(c) of the SCM Agreement relevant in this regard?

9. If there were no private sector market for such instruments, contrary to what Brazil has suggested, the mere fact that a financial service would be provided only by a government entity could not be determinative of the existence of a benefit. As indicated by the Appellate Body in *Canada - Aircraft I*, whether a benefit has been conferred can be determined by whether a recipient has received a financial contribution on terms more favourable than those available to it in the market.[11]

10. The Appellate Body found that Article 14 of the SCM Agreement is relevant context in interpreting Article 1.1(b) and supports its view that the marketplace is an appropriate basis for comparison.[12] However, there is no reason why Article 14(c) would be more relevant than any other part of Article 14, because Article 14(c) addresses loan guarantees, which are not at all equivalent to equity or first-loss deficiency guarantees.

11. As Canada argued at paragraph 38 of its 31 July 2001 Oral Statement, the question of whether or not a "benefit" is conferred by equity guarantees (first loss deficiency guarantees) provided by IQ is a function of whether or not the recipient (*i.e.* the aircraft purchaser) obtains the financial contribution on terms more favourable than those available to it in the market.

12. Clearly this is not the case. As Canada stated in its 26 July answer to Question 47 of the Panel, "[t]he 'market rate' nature of the guarantee can only be demonstrated considering the value of the financial service that is being provided in the light of the risk exposure of the service provider." In its response, Canada established that, as a result of [], IQ is being properly remunerated for the effective risk it undertakes. Brazil has offered no evidence to the contrary.

13. Canada's answer to the Panel's question remains the same even when examined from the point of view of Bombardier as a potential recipient of the benefit. If the aircraft purchaser is not receiving the financial contribution on terms more favourable than would otherwise be available in the market, it cannot be argued, as suggested by Brazil, that it has been influential to Bombardier's sales.

Question 71

With reference to paragraph 105 of Brazil's oral statement of 31 July 2001, please clarify the dates of the Air Nostrum transaction.

1. There is no discrepancy as to the date on which the IQ equity guarantee was provided. Canada's answer to Question 14 from the Panel related to IQ's involvement in the Air Nostrum sale. The first approval of an equity guarantee by IQ was given in December 1997 as described in Exhibit CDA-64. However, in its answer to Question 41 of the Panel, the documents that Canada provided as Exhibit CDA-64 did not reflect the final terms and conditions of the guarantee provided by IQ. A second approval was later provided in June 1998 (see Exhibit CDA-77 which contains the final recommendation and transaction summary). Canada was not previously aware of the existence of the second set of documents for this transaction and apologizes for this error.

2. As a result of this second approval, the IQ equity guarantee was [] per cent to [] per cent of the aircraft purchase price. As evidenced by Exhibit CDA-77, the applicable IQ equity guarantee is for a maximum of [] per cent of the aircraft purchase price. This equity guarantee is also subject to a

[11] *Canada – Aircraft I*, Appellate Body Report, para. 157.
[12] *Id*., para. 158.

[]. The [] per cent is also in a more secure position within the financing structure than the [] per cent that IQ would normally take in other transactions because Air Nostrum provided a []. In a normal transaction, after the [], IQ holds the tranche []. In this case, as a result of [], IQ holds a lesser-exposed tranche, [].[13] IQ's guarantee is provided in exchange for a fee calculated in the usual manner.

3. The IQ Board of Directors approved the provision of its guarantee in January 1999. With respect to EDC's Canada Account involvement, the Government of Canada provided approval in principle in December 1997. Deliveries began in May 1999, not 1998, and were concluded in November 1999. Contrary to Brazil's assertion in paragraph 105, EDC and IQ supported the delivery of only five aircraft. They did not provide support for any options.

Question 72

Please comment on paragraph 135 of Brazil's second written submission.

1. To the best of its knowledge, Canada has provided all of the documentation that exists regarding the review of these transactions by IQ. Brazil's statements that additional documentation would have shed light on whether IQ guarantees conferred benefits and would have provided further information about conditions such as a requirement that the aircraft be exported are entirely conjectural. Canada has provided a detailed description of IQ's review of each transaction as well as the result of the internal credit analysis. That is, Canada has provided all available information relevant to the Panel's determination of the benefit and export contingency issues.

2. The statements in paragraph 135 are, moreover, an acknowledgement by Brazil that it has failed to establish whether IQ's guarantees did confer a benefit within the meaning of Article 1 of the SCM Agreement and also that it has failed to establish that the guarantees were contingent, either in fact or in law, upon exportation.

3. Brazil's request, in paragraph 136, that the panel reach these conclusions by way of "adverse inference" is unwarranted and insupportable and a further acknowledgement that the evidence does not support Brazil's claims. Brazil's request is particularly inappropriate because it would require the Panel to ignore the exculpatory evidence that Canada did provide at the Panel's request and despite Brazil's failure to establish a *prima facie* case. Brazil cannot offload its burden of proof to Canada and the Panel by making unsubstantiated allegations against Canada, calling on Canada to substantiate them, and then asking the Panel to draw adverse inferences when Canada fails to do so.

[13] [].

ANNEX B-12

RESPONSE OF CANADA TO ORAL STATEMENT OF BRAZIL AT THE SECOND MEETING OF THE PANEL

(13 August 2001)

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I. INTRODUCTION

1. This submission refutes the new arguments raised by Brazil in its 31 July 2001 second oral statement. The first part of the submission explains why Brazil's arguments alleging general shortcomings in EDC's pricing methodology are without foundation. The second part of this submission reviews EDC's pricing analysis and strategy in the transactions that Brazil has identified. It demonstrates that the factors EDC considered in establishing its pricing were entirely appropriate and resulted in pricing that was on terms available in the market. In fact, in some of the instances that Brazil has identified, involving Comair and Atlantic Coast Airlines, other commercial financial institutions were able to out-compete EDC to provide financing for Bombardier regional jet sales.[1] The third part of this submission refutes new allegations Brazil has made in its 31 July statement regarding Investissement Québec.[2]

2. This submission also includes two annexes. Annex I explains in detail the fundamental flaws in Exhibits BRA-65 and BRA-66, in which Brazil purports to show that EDC's pricing is below market by comparing it with EETCs. Annex II revisits and analyzes the data that Brazil relied on in its exhibits to its 31 July statement, including Exhibits BRA-65 and BRA-66. Annex II reviews EDC pricing in terms of market comparables and again demonstrates that EDC's offers involving ASA, Comair, ACA and Kendell were on market terms.

II. BRAZIL'S CHALLENGE TO EDC'S PRICING METHODOLOGY IS WITHOUT MERIT

3. In its 31 July statement, Brazil makes a number of arguments as to why EDC's pricing methodology for specific Corporate Account transactions was incorrect. In essence, Brazil is asking the Panel to second guess both the manner in which EDC developed its pricing strategies and, more important, the pricing that EDC provided in specific transactions. There are two fundamental problems with Brazil's position.

4. First, Brazil's data and arguments purporting to show errors in EDCs methodologies and pricing are misleading, irrelevant or simply incorrect. In this submission, Canada reviews the data that Brazil has used in the transactions in question and demonstrates that when the correct benchmarks are applied, it is clear that EDC's pricing was very much at "market".

5. Second, Brazil is asking the Panel to substitute Brazil's judgement as to the appropriate pricing in these transactions for the judgement exercised at the time by EDC. The pricing of aircraft financing offers by commercial financing institutions is a highly technical and specialized exercise requiring both the objective and subjective consideration of a large number of factors. Canada has included in this response a comprehensive summary of the analysis and pricing of the transactions identified by Brazil, which confirms that these transactions were on market terms and that Brazil's attempts to show otherwise are baseless.

6. The Panel should consider, for example, the Kendell transaction, which offers excellent empirical proof that Brazil's constructed "market spreads", based on EETCs, are completely unfounded. The Kendell transaction was priced by commercial banks. EDC was simply a participant. According to Exhibit BRA-66, a "market spread" for the Kendell transaction should have been [] bps over US Treasury. However, the uncontroverted evidence shows that Kendell was able to arrange financing for that transaction in the commercial marketplace for [] basis points less than what Brazil claims was an "appropriate" market spread. Brazil cannot seriously be suggesting that the Panel

[1] See *infra*, paras. 15 and 86.

[2] Brazil's 31 July statement makes no new arguments concerning either Canada Account generally or the Air Wisconsin transaction.

should rely on Brazil's construction of what it asserts the market spreads should have been, when the empirical evidence proves that EDC's customers were actually able to obtain far lower interest rate spreads in the commercial marketplace.

A. EDC's Credit Ratings

7. In its 6 July submission, Canada noted that in establishing its pricing, EDC considers the credit rating generated by the LA Encore (now Moody's Risk Advisor) software for each borrower or the third-party credit rating in the event that a public credit rating was available.[3]

8. In its 31 July statement, Brazil attempts to challenge the validity of EDC's credit ratings, as well as the other benchmarks EDC uses. Brazil's challenge is groundless.

9. At paragraph 54 of its statement, Brazil asserts that LA Encore overstates airlines' credit ratings because they are higher than those EDC generated before it had access to LA Encore. Brazil ignores a fundamental difference between the nature of the LA Encore ratings generated by EDC and the ratings EDC generated before LA Encore was available. Prior to LA Encore, EDC did not attempt to assign precise credit ratings for potential customers. It simply determined whether the borrower []. Thus, Brazil is mistaken in asserting that EDC's pre-LA Encore ratings for Comair and ASA were []. EDC's pre-LA Encore ratings meant that Comair and ASA were at least []. EDC's subsequent LA Encore ratings were more accurate than those EDC was previously able to generate and demonstrated that EDC's pre-LA Encore ratings were conservative.

10. Although Brazil has offered no credible substantiation for its assertions that LA Encore itself or as used by EDC is flawed, Canada has, nevertheless, provided additional documentation of the reliability of this credit rating tool and EDC's application of it, in its 8 August answer to the Panel's Question 66.

B. Other Common Pricing Sources Used By EDC

11. Canada also described in its 6 July submission that in addition to credit ratings, in establishing pricing EDC considers common industry pricing sources to determine pricing for comparable credit rating situations. Industry sources for such pricing data include, *inter alia*, Bloomberg Fair Market Curves, pricing offered to comparable bank pricing, bond market pricing, structured transaction pricing (i.e. EETCs), as well as on-going contacts with financial institutions.[4]

12. In its 31 July statement, Brazil takes issue with individual elements of EDC's pricing strategies. In so doing, Brazil appears to treat each element as though it were determinative and to ignore the other elements described in the documentation Canada has provided. Brazil's approach therefore is misrepresentative of EDC's methodology and cannot demonstrate that the pricing EDC offered was more favourable than that available in the market. Moreover, the assertions Brazil makes regarding these isolated elements do not stand up to scrutiny.

(i) EDC's Consideration of Its Previous Transactions

13. For example, at paragraph 57 of its 31 July statement, Brazil asserts that EDC acted inappropriately by considering its own previous transactions in the course of developing a pricing strategy. Brazil also asserts that EDC's actions demonstrate that Canada falsely stated that it defines the "market" exclusive of export credit agencies in its answer to the Panel's Question 4. This is yet another example of Brazil's unfortunate tendency to take evidence out of context.

[3] Canada's Answer to the Panel's Question 4.
[4] *Id.*

14. EDC does consider its previous transactions. However, EDC does not use these transactions to determine what a borrower has recently paid in the "market". Moreover, EDC neither relies exclusively on its own pricing of previous credits nor does it simply apply the same price to new credits. Rather, EDC considers its own previous pricing in order to ensure consistency and completeness in new transactions. Thus, EDC reviews, among other things, the pricing methodology it used for previous transactions and the benchmarks it used in those transactions and compares them to its methodology and benchmarks for the new transaction.

(ii) Other Comparables

15. Brazil also takes issue with other comparables that EDC has used in pricing its transactions. Brazil has failed to explain why EDC should not have considered industrial bonds. As well, Brazil suggests that EDC should have used the data regarding Bombardier regional jet transactions that did not involve government support.[5] Where such information is available, EDC does consider it to the extent that it is relevant. Although Brazil seems to assert, at paragraph 56 of its 31 July statement, that EDC has never considered the rates offered by commercial banks financing Bombardier's aircraft, the evidence shows otherwise. Thus for example, Canada's Exhibit CDA-59 shows that EDC considered a competitive bid that Comair had received at US Treasury plus [] in determining its pricing and the fact that EDC was not selected by the airline to provide the financing for [] previous aircraft due to a more favourable offer by European commercial banks.

16. However, it is often difficult to obtain complete information on the financing provided by banks and other financial institutions due to their confidentiality policies. As a result, lenders must often consider in their analyses, statements by airlines, loan arrangers and other participants relating to previous financing offers.

17. To the extent that such information is available, as for example in the second Kendell financing (Exhibit CDA-66), it confirms that EDC's pricing was at or even above commercial market financing. Similarly, as described in Annex II to this statement, EDC's 1999 financing to Atlantic Coast Airlines (ACA) was priced [] to [] than financing ACA arranged at approximately the same time with [] and well higher than earlier financing ACA had received from other commercial sources.[6] Moreover, the February 1996 term sheet by EDC to ACA, on which Brazil relies, was rejected by ACA because it could – and did – obtain better pricing in the private commercial market than the price EDC was prepared to indicate at that time.

18. In paragraph 60 of its 31 July statement, Brazil suggests that EDC was wrong to use the financing of a [] as one comparative element in the Kendell financing. Brazil fails to explain why this comparison was irrelevant other than to assert that it is "obvious". Contrary to Brazil's assertion, it is relevant to compare a proposed USD [] million financing "to a small non-US regional airline" (i.e, Kendell) with the financing of USD [] million sale to a like-rated US airline, i.e. []. Moreover, Brazil fails to acknowledge that the pricing and all other terms EDC offered Kendell were the same as those offered by the seven commercial banks that participated in the transaction along with EDC.

19. Finally, in paragraph 61 of its 31 July statement, Brazil takes issue with the fact that one of the elements EDC sometimes considered was financing offered by []. In that paragraph, Brazil repeats an assertion it made in the *Canada- Aircraft I* dispute that [ ]. Brazil knows this allegation is untrue. When Brazil first made it, Canada stated: []

[5] Brazil's 31 July Statement, paras. 55 and 56.
[6] Annex II, p. 6.

20. At the time, Canada submitted documents proving that [] was a for-profit company created by a [], as an instrument for commercial regional aircraft financing involving institutional investors. It has no ties whatsoever to the Governments of Canada or Quebec or to EDC. Canada resubmits the exhibits that show this, as Exhibit CDA-78.

(iii) Brazil Misrepresents the Relevance of Other Airlines' Debt Financing

21. Brazil also attempts to show that EDC's rates are below market with reference to statements that Canada made, in the *Brazil – Aircraft* dispute, regarding the risk premiums for certain debt financing by certain major airlines.[7] In so doing, Brazil misrepresents and distorts Canada's argument in that dispute.

22. The essence of Canada's argument was that the rate offered under PROEX II, US Treasury plus 20 bps, was not available in the market.[8] Moreover, Canada cautioned that although that rate was under no circumstances available, the other rates to which it referred – and to which Brazil now refers in its 31 July statement – do not establish a hard limit for the international aircraft financing market. As Canada explained:

> Prevailing market conditions, different payment profiles, or terms, or other conditions negotiated between a lender and a borrower could affect the final interest rate, resulting in higher or lower rates [than those to which Canada referred in that proceeding].[9]

23. Nevertheless, in paragraphs 48 and 49 of its 31 July statement and Exhibit BRA 64, Brazil attempts to attribute to Canada the position that: "For a '*representative*' airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up to T-bill +250 bps." This is patently false. Exhibit BRA-64 describes the weighted average of particular tranches of airline debt. It does not describe a generically appropriate interest-rate spread based on an airline's credit rating.[10]

24. Nowhere in the submissions Brazil cites, did Canada argue on the basis of that data that airlines from AAA to BBB- would have to pay spreads of up to 250 bps over US Treasury. Moreover, while Canada pointed out the rates that British Airways was paying at the time as the best-rated non-sovereign airline, Canada did not argue that highly rated airlines would have to pay US Treasury plus 125 bps or more. Canada could not have made such an argument: the data Canada provided (now Brazil's Exhibit BRA-64) shows that American Airlines, which at the time was rated BBB- by Standard & Poor's, was paying, on a weighted average basis, 111 bps over US Treasury.

25. In addition, Brazil has failed to recognize that the market for the debt of these and other externally-rated airlines is dynamic; it depends on such factors as company performance, the underlying assets and the general economic climate. These factors, among others, can and do affect the creditworthiness of these airlines, and consequently, the financing terms they can be expected to receive. Brazil has made no attempt to link these rates to the specifics of the EDC transactions nor to the time at which EDC made its offers.

(iv) Other Considerations

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[7] Brazil's 31 July Statement, paras. 47-50.

[8] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, Annex I-2, Rebuttal Submission of Canada, para. 51; WT/DS46/RW, Annex I-5, Canada's Comments on Brazil's Responses to Questions of the Panel, para. 10.

[9] *Id*, para. 11.

[10] Nor did Canada suggest that the representative airlines to which it referred in Exhibit BRA-64 were rated at or above BBB-. Standard & Poor's rated Northwest as BB and rated US Air even lower: B.

26. Brazil's misleading attempts to isolate single considerations and present them as determinative are similarly in evidence in paragraphs 58 and 60 of its 31 July statement. In paragraph 58, Brazil argues that "it seems reasonable to assume that" one of EDC's considerations in the 1996 Comair transaction, [], was a "determining' factor in deciding which transactions to finance and at which rates. Thus, Brazil attempts, without evidence, to extend this consideration to all EDC financing.

27. Furthermore, although Brazil contends that [] has nothing to do with the market rate for the deal", a review of Annex-2 in Exhibit CDA-59 makes clear that [] was very much related to the market rate. The first sentence of Annex-2 states that the [] Bombardier to offer Comair []. Thus in order to be competitive on the financing, EDC would have to price its offer in the US Treasury plus [].

28. Canada's Exhibit CDA-59 also shows that the transaction's [] was just one of several considerations for EDC. Among the others were that EDC had been underbid by commercial banks on previous Comair financings, that Comair had received another bid at US Treasury plus [] and the good quality of the credit risk and asset security involved.

C. Brazil's Use of EETCs Is Fundamentally Flawed

29. A substantial part of Brazil's new argumentation in its 31 July submission attempts to show, with reference only to Enhanced Equipment Trust Certificates (EETCs), that specific EDC corporate account transactions were priced below market and thereby conferred a benefit.[11] Brazil's Exhibits BRA-65 and BRA-66 both purport to show this. Brazil contends that its reliance on EETCs in attempting to make out its case is akin to Canada's references to EETCs in the *Brazil – Aircraft* dispute. This assertion is disingenuous. Brazil's position is also contrary to its own position in the *Brazil – Aircraft* dispute.

30. In *Brazil – Aircraft*, Canada referred to EETCs to show that the CIRR alone – that is, the CIRR independent of other terms and conditions such as the loan-to-value ratio and the length of financing – is not an appropriate market benchmark and to refute Brazil's assertion that it is.[12]

31. Canada never suggested that EETCs could identify the "market" spread for a particular regional aircraft financing transaction, nor did it rely on EETCs for that purpose. Brazil too, considered that EETCs were an unreliable benchmark for particular loan transactions. This is what Brazil said about EETCs:

> 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.[13]
>
> 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 [sic]

[11] See, e.g., Brazil's 31 July Statement, paras. 62-76.

[12] *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, not yet adopted, Annex A-2, para. 88.

[13] *Id*., Brazil's Comments on Responses to Questions by Canada and Third Parties, Annex B-6, para. 19.

> return expectations based on a range of commercial papers, with comparable coupons, yields, maturities, credit ratings, etc.[14]

32. Brazil also argued in that dispute that the spread on EETCs at a given point in time, "is misplaced". According to Brazil, "[t]hat 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."[15]

33. Brazil noted that the data in the 10 February 2001 Morgan Stanley Dean Witter Report on which Canada relied (Exhibit CDA-17 in that dispute), "itself shows [that] 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."[16]

34. Canada does not dispute the use of EETC's as *one* among several benchmarks for establishing pricing in spite of the fact that only a small percentage of regional aircraft have been financed to date utilizing this financing instrument. However, according to two leading arranger/advisors to the regional aircraft industry, the interest rates offered to the airlines through not only export credit agencies but also by private banks and finance companies have been more favourable (i.e. lower) than EETC's.[17] Brazil's exclusive use of EETCs as a sole bench mark for establishing pricing for the regional aircraft industry is not appropriate, as Brazil itself recognized in its submissions in the *Brazil – Aircraft* dispute.

35. In Annex I to this submission, Canada sets out precisely why Exhibits BRA-65 and 66, in which Brazil purports to show that EDC's pricing is below market by comparing it with EETCs, are fundamentally flawed.

36. For example, Brazil uses the weighted average of all EETC issues for a particular year. Nowhere has Brazil indicated that it has considered the varying underlying credit ratings of the individual airlines or EETC loan tranches. Neglecting to consider the creditworthiness of different borrowers is a fundamental flaw. Nor does it appear that Brazil has considered the varying age or type of the underlying assets (for example, whether they are jets at all), or the market's appetite for these assets. Brazil's analysis also fails to address terms to maturity, loan-to-value ratios, liquidity features and cross-collateralization of the various issues.

37. Taken together, these methodological flaws render Brazil's analysis meaningless.

38. BRA-66 also cites "industry sources" for the addition of 20 basis points in calculating a benchmark for non-US EETCs. However, EETCs have met with only limited success outside of the US market for various tax and cost reasons. Well-rated, non-US airlines such as British Airways, SAS and Lufthansa, whose credit ratings rival those of the higher rated EETC tranches, are able to fund themselves at attractive rates outside of a EETC structure.

39. In Brazil's 8 August response to questions from the Panel, it noted that a 8 June 2001 Salomon Smith Barney report cited a number of reasons for the yield premium enjoyed by EETCs over the generic bond market. Though Salomon Smith Barney has correctly identified this spread, a 9 May 2001 report from the same brokerage house cited quite different reasons for this apparent

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[14] *Id*., para. 21.
[15] *Id*., para. 23.
[16] *Id*.
[17] See letter from [], to N. Taylor, Vice President, Sales Finance, Structured Finance, Bombardier Inc., dated 7 August 2001; and letter from [], to N. Taylor, Director of Structured Finance, Bombardier Capital, Inc., dated 8 August 2001. (Exhibit CDA-79).

gap.[18] These reasons included perceptions that this sector is not very liquid, or at least not as liquid as other corporate sectors, EETCs' relatively new appearance in the fixed income arena, and that the EETC market does not yet have the same depth and, thus, liquidity characteristics as some of the most actively traded corporate sectors such as bank and finance, oil and gas, and media and telecommunications.

40. Based on the foregoing, it does not appear there is consensus, even within Salomon Smith Barney, as to the reason for the apparent spread between EETC issues and generic bond spreads. This is not surprising. In the 8 June report submitted by Brazil, Salomon Smith Barney admits to its "limited knowledge of the asset-backed, mortgage backed, and collateralized debt obligations markets."[19]

III. SPECIFIC TRANSACTIONS

41. The foregoing review demonstrates that none of Brazil's arguments regarding EDC's methodology or pricing stand up to scrutiny. It is still uncertain if Brazil is challenging any transactions "as such". (In its response to the Panel's Question 60, Brazil states that its "challenge is to how the measures [Corporate Account, Canada Account and Investissement Quebec] are applied generally, the evidence of which is found in specific transactions.") Nevertheless, in order to demonstrate once and for all that the transactions Brazil has identified in its 31 July statement, involving ASA, Comair, ACA, Air Nostrum and Kendell were priced at market, Canada offers the following review of these transactions.[20] This review examines the market benchmarks EDC employed in each transaction as well as providing further insight into the market at the time the pricing strategy for each transaction was developed.

42. In addition, in Annex II to this submission, Canada has revisited and analyzed the data that Brazil relied on in its exhibits to its 31 July statement, including Exhibits BRA 65 and BRA-66. Annex II, which analyses EDC pricing in terms of market comparables, again demonstrates that EDC's offers involving ASA, Comair, ACA and Kendell were at market.

A. Atlantic Southeast Airlines (ASA)

Pricing Strategy	Letter of Offer
December 1996	March 1997
August 1998	August 1998

43. In its 31 July attack on the Corporate Account pricing of ASA, Brazil discusses only the issue of EDC's credit rating for ASA and the EETC market at the time of the individual pricing strategies.

44. As previously explained, Brazil's challenge to EDC's rating for ASA stems from a fundamental misunderstanding. At the time of EDC's first offer, LA Encore had not been developed and EDC had been satisfied that on the basis of the airlines most current and previous financial information the airline's *unsecured* rating was *at least* []. This did *not* mean that EDC rated ASA as [].

[18] Salomon Smith Barney, *The EETC Trading Observer*, 9 May 2001, pp. 7. (Exhibit CDA-80)

[19] Salomon Smith Barney, *The ABCs of EETCs: A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, p. 36. (Exhibit BRA-71)

[20] As described in this section, the Air Nostrum transaction is anomalous in that it matched an offer of financing by the Government of Brazil. Canada's offer was structured as a matching Canada Account tranche (offered at what would be below market terms) as well as a Corporate Account tranche offered on market terms.

45. As Brazil has noted, aircraft-secured US airline debt qualifies for special protection under Section 1110 of the US Bankruptcy Code. Section 1110 allows the lessor/conditional vendor to repossess its collateral security within 60 days of a bankruptcy claim if the collateral is an aircraft or aircraft parts.

46. The major credit rating agencies recognize legal support afforded under Section 1110 for continuing payment that does not depend directly on collateral value. As such this debt can receive a higher rating than standard secured debt. For example, Standard & Poor's differentiates by one rating designation secured debt under Section 1110 versus standard secured debt for investment grade borrowers, and differentiates by two rating designations for sub-investment grade borrowers.[21]

47. Brazil also disregards the elements that EDC took into account in addition to the LA Encore rating. The December 1996 ASA pricing strategy considered the pricing developed for Comair earlier the same month (discussed in greater detail below but which considered a number of non-EDC benchmarks) and compared the relative performance of each airline, as well as a number of other regional airline peers. The comparison in the ASA strategy included *inter alia* a review of revenue, net income, shareholder's equity, market capitalization and operating statistics (e.g. revenue passenger miles, available seat miles, load factors and break even load factors).

48. EDC also considered the ASA's 1994 acquisition of [] for which ASA was able to obtain financing at [] and an unconfirmed report it had received of a recent Comair financing of [] CRJ aircraft at [].

49. The pricing offered by EDC to ASA was above both these market benchmarks.

50. EDC also noted that at the time of the airline's most recent financial statements ASA had a secured, unutilized USD [] million line of credit with its local bank at [] (which would have been equivalent to 10 year UST + [] based on then current swap rates).

51. The pricing offered by EDC to ASA was above this market benchmark.

52. It is also noteworthy that Brazil chose to ignore the backstop support offered to EDC by [] which compensated EDC by [] bps should the airline's (external or EDC's internally generated) credit rating [] or [] during the disbursement period. Further compensation was to be negotiated should the ASA rating [] during the disbursement period.

53. Finally, at the time of the pricing strategy, which resulted in EDC offering 10 year UST + [] bps to the airline, the Bloomberg Fair Market Curve (FMC) indicated the following rates for *unsecured* credits of US rated industrials:

Rating[22]	**Fair Market Yield Curves**[23]	**Spread**
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

54. The EDC pricing was above the FMC market benchmarks for all [] credits.

[21] Salomon Smith Barney, *The ABCs of EETCs: A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, p. 22. (Exhibit CDA-81)

[22] A rating scale comparison of Bloomberg to Moody and Standard & Poors is provided in Exhibit CDA-82.

[23] See Exhibit CDA-83. Ten-year US Treasury is [].

55. In August 1998, EDC undertook a further review of ASA's pricing and prepared another pricing strategy which confirmed the existing UST + [] bps pricing. By this time, LA Encore was operational and generated an *unsecured* rating of "[]" for ASA.

56. Once again, EDC's pricing strategy considered the recent performance of ASA in comparison with its peers. The pricing strategy also discussed the airline's successful implementation of the CRJ aircraft into its operations and the company's improved financial stability.

57. EDC also referred to an August 1997 pricing strategy for Comair (discussed below) as well as the FMC. As well, EDC's assessment considered that in spite of the availability of an average life of up to [] years, ASA's ten most recent EDC supported deliveries had an average life of only [] years. Therefore EDC used as a comparable an interpolated [] year UST FMC spread for unsecured credits of US rated industrials.

58. The relevant FMC data were:

Rating	Fair Market Yield Curves[24]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	9 year UST + [] (interp)
[]	[]	9 year UST + [ ](interp)
[]	[]	9 year UST + [] (interp)

59. The EDC pricing was higher than the FMC market benchmark for all [] rated credits.

60. As before, [].

B. Comair

Pricing Strategy	Letter of Offer
April 1996	July 1996
December 1996	December 1996
December 1996	March 1997
August 1997	August 1997
August 1997	August 1997
August 1997	September 1997
March 1998	March 1998
March 1998	April 1998
January 1999	February 1999

61. In its 31 July attack on the Corporate Account pricing for Comair, Brazil again discusses only the issue of EDC's credit rating for Comair and the EETC market at the time of the individual pricing strategies.

62. In April 1996, EDC developed pricing for Comair. LA Encore was not available at that time. EDC determined that Comair's financial performance would warrant an *unsecured* [], based on EDC's internal methodology which considered Comair's current and previous financial statements.

[24] See Exhibit CDA-84. Ten-year US Treasury is [].

63. As previously noted, the confidential nature of the financial services sector makes exact market comparables difficult to obtain or verify. However, as described in the documentation Canada previously submitted, EDC had been advised by a leading arranger in the regional aircraft industry, [], that [] had been recently financed by [ ] at an all-in rate of UST + [].[25] In addition, EDC was advised that a Dutch bank had financed an additional [] purchases at UST + [] all-in.

64. EDC's strategy also noted EDC pricing that had been indicated to other regional airlines and was in turn supported by similar pricing benchmarks. The strategy considered the performance of these airlines in comparison with Comair (in particular, the Atlantic Coast Airlines pricing indication, which is described in more detail below).

65. The then-current FMC data for unsecured credits of US [] rated industrials were as follows:

Rating	Fair Market Yield Curves[26]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

66. EDC's offered pricing of UST + [] was consistent with all of these market benchmarks and well above the then-current [] FMC benchmarks.

67. In December 1996, Comair asked EDC to reconsider its pricing. EDC conducted a further review which resulted in it offering UST + [] to Comair. Though LA Encore was still not available, EDC determined, based on Comair's continuing strong performance, that Comair's rating would not be any less than previously determined, i.e. [].

68. This review considered not only the previous bank financings but also the financing of [] additional [] purchases by a number of European banks at [], on [] year terms.[27]

69. At the time EDC developed this pricing strategy (6 December 1996), the FMC data for unsecured credits of US rated industrials were as follows:

Rating	Fair Market Yield Curves[28]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

70. The pricing offered by EDC exceeded all of these FMC market benchmarks.

71. In August 1997, Comair again asked EDC to reconsider its pricing. By this time the LA Encore system was in operation and generated an *unsecured* rating of [] for Comair.

72. The pricing strategy EDC developed considered the CRJ financings by European banks, recent [] closings, as well as the indication that Comair had financed [] CRJs at LIBOR + [].

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[25] See Exhibit CDA-59, p. 4.
[26] See Exhibit CDA-85. Ten-year US Treasury is [].
[27] Exhibit CDA-59, p. 6.
[28] See Exhibit CDA-86. Ten-year US Treasury is [].

73. EDC also undertook a financial comparison between ASA and Comair. It concluded that Comair was at least as creditworthy as ASA and should therefore command similar pricing. This comparison also noted the previously mentioned non-EDC ASA financings.

74. The FMC data for unsecured credits of US rated industrials at this time (8 August 1997) were as follows:

Rating	Fair Market Yield Curves[29]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

75. EDC's offered pricing of UST + [] bps was in excess of all the [] FMC market benchmarks.

76. In March 1998, at the airline's request, EDC also offered to provide Comair []financing with a [] *year* repayment term at 7 *year* UST + []. EDC deemed this appropriate based on the then-current performance of Comair itself and in comparison with ASA.

77. The FMC data for unsecured credits of US rated industrials at this time (10 March 1998) were as follows:

Rating	Fair Market Yield Curves[30]	Spread
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []
[]	[]	7 year UST + []

78. EDC's offered pricing was in excess of all the [] FMC market benchmarks.

79. In early 1999, EDC developed its most recent Comair pricing strategy. At this time LA Encore had generated an unsecured rating of [] for Comair.

80. EDC's pricing strategy considered a basket of US industrials including banks, industrials and consumer goods companies with a like credit rating and actively trading bonds with a similar term to maturity as the average life of the proposed financing. The average spread on these bonds was UST + [].

81. This market-based average was less than the EDC offered pricing of UST + [].

82. EDC also considered a number of pass-through certificates (i.e. loan notes) and EETCs, including those of []. The average spread of those certificates and EETCs, which had a similar average life ([]) as that in the EDC offer to Comair, was [] bps over the ten year UST. This was less than EDC's offered pricing.

[29] See Exhibit CDA-87. Ten-year US Treasury is [].
[30] See Exhibit CDA-88. Seven-year US Treasury is [].

83. The FMC data for unsecured credits of US rated industrials at the time of the strategy were as follows:

Rating	Fair Market Yield Curves[31]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

EDC's offered pricing of UST + [] bps was in excess of the [] to [] rated FMC market benchmarks.

C. Atlantic Coast Airlines (ACA)

Pricing Strategy	Term Sheet
February 1996	February 1996
Pricing Strategy	Letter of Offer
January 1999	March 1999

84. In its 31 July attack on the Corporate Account pricing for ACA, Brazil discusses EDC's credit rating for ACA and the EETC market at the time of the individual pricing strategies. In addition, Brazil mentions an EETC issue of ACA.

85. EDC has provided financing for the delivery of [] CRJ aircraft for Atlantic Coast Airlines (ACA) and [] CRJs for Atlantic Coast Airlines Holdings (ACAH).

86. EDC issued an indicative term sheet to ACA in 1996 at UST + [].[32] However, in spite of on-going discussions with the airline, agreement could not be reached regarding terms and conditions of the EDC financing structure and ACA secured financing elsewhere.

87. Subsequent to the issuance of this term sheet, EDC was advised by [], a leading aircraft financing arranger, that ACA would likely be able to secure a private placement in the UST + [] bps range or arrange debt in a USLL structure in the UST + []bps range.

88. The EDC term sheet's indicative pricing was higher than these market benchmarks.

89. In September 1997, ACA completed a EETC for a number of its CRJs and turbo-prop aircraft in the UST + [] bps range, exclusive of fees.[33]

90. The pricing terms and conditions for EDC's financing of ACA were established by a letter of offer dated 3 March 1999. The pricing strategy for this letter of offer was principally developed in January 1999. It provided floating rating financing at LIBOR + [] or fixed rate financing for aircraft delivered prior to 1 January 2000, at UST + [] (based on then current swap rates the fixed rate equivalent of L + [ ] was UST + []). Fixed financing rate for aircraft delivered after 1999 would be available at LIBOR + [] plus the applicable premium to swap floating rate to fixed rate debt.

[31] See Exhibit CDA-89. Ten-year US Treasury is [].

[32] An indicative term sheet is for discussion purposes only and is subject to further due diligence. It does not represent the final terms and conditions, including relevant pricing, which may be offered by EDC.

[33] This small, illiquid EETC is not frequently traded and with the exception of the issue price does not provide a good "on the run" benchmark. For this reason, Salomon Smith Barney does not include this issue in its EETC data base. (Salomon Smith Barney, *The ABCs of EETCs: A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, p. 33 (Exhibit CDA-81).

91. By this time LA Encore was available and generated an *unsecured* rating of [] for ACAH, the []. EDC's pricing considered these factors as well as the financial and operating performance of the airline relative to its peers, and past and current EDC pricing for other US regional airlines.

92. The FMC data for unsecured credits of US rated industrials at the time of the strategy (12 January 1999) were as follows:

Rating	Fair Market Yield Curves[34]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

93. EDC's offered pricing of UST + [], plus an up-front administration fee of [] (equivalent to UST + [] all-in), was consistent with the then current [] rated FMC market benchmarks.

94. In May 2000, EDC agreed to the airline's request to a minor amendment of the [] of the March 1999 letter of offer. At that time EDC also confirmed its pricing of the credit based on a pricing review undertaken in November 1999 for ACAH. At the time of this review, ACAH had an *unsecured* LA Encore rating of [].

95. By November 1999, EDC had financed [] of ACA's [] CRJs. ACA had financed the balance by a combination of EETCs ([] aircraft), [] ([] aircraft), [] ([] aircraft) and [] ([] aircraft). EDC's pricing strategy noted that the EETC was not trading, so the current market spread was not available. However, EDC was advised that the [] aircraft were financed in 1998 at a rate of UST + [] with a [] year term. In addition, [] committed to finance up to [] CRJs in early 1999 at LIBOR + [] (or approximately UST + [] based on November 1999 swap rates). []'s financing was to be made available into a USLL structure with a []-year term and a []-year average life or a direct loan with a [] year payout.

96. EDC's offered pricing was greater than all of these active market benchmarks.

97. In addition, ACA had informed EDC that it had received interest from a number of banks for its upcoming deliveries and, as such, it expected to use EDC financing for only [] of the airline's [] remaining deliveries. Clearly, if EDC pricing was below market, ACA would have sought to use EDC financing for *all* of its remaining deliveries.

98. At the time of the second pricing strategy (24 November 1999) the applicable FMC data for unsecured credits of US rated industrials were as follows:

Rating	Fair Market Yield Curves[35]	Spread
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []
[]	[]	10 year UST + []

[34] See Exhibit CDA-90. Ten-year US Treasury is [].
[35] See Exhibit CDA-91. Ten-year US Treasury is [].

99. EDC's offered pricing of UST + [], plus an up-front administration fee of [] (equivalent to UST + [] all-in) was greater than all the then-current [] FMC market benchmarks.

D. Air Nostrum

Pricing Strategy	Letter of Offer
March 1998	October 1998

100. Air Nostrum is a regional airline based in Valencia, Spain. As such, US benchmarks were not applicable. Both Embraer and Bombardier competed for this order. Air Nostrum confirmed to EDC that the Government of Brazil had offered long term financing for the Embraer contract, which was not consistent with OECD Consensus terms. Air Nostrum told EDC that Brazil's terms were:

- Price: USD 14.8 million (January 1998 $)
- Financing: 100 per cent from BNDES at 5.13 per cent per annum (after a Proex I buydown) for 15 years to a balloon of 35 per cent.
- This equated to a monthly lease rate of USD 98,451.

101. On the basis of this information, EDC, with Canada Account support, provided a financing proposal which attempted to match the lease payment structure required by Air Nostrum but with a higher all-in rate than that being offered by Brazil. EDC notified the OECD of its intention to match Brazil's offer.

102. EDC's Corporate Account tranche ([] per cent loan-to-value) is the senior tranche in this transaction. It is secured by, *inter alia*: a first priority mortgage on each aircraft; an assignment of all manufacturer's warranties, and EDC being first loss payee under appropriate insurance policies. EDC's Corporate Account tranche is fully covered by the residual value of the assets.

103. Though the overall pricing was driven by Canada's desire to match the Brazilian offer and to meet Air Nostrum's lease payment structure requirements, it was also based on a review of the airline's financial and operating performance. The Corporate Account pricing was included a market-based interest rate of the [ ].

E. Kendell Airlines

104. Pricing Strategy	Signing of Participant Accession Agreement (EDC commitment)
June 1999	August 1999

105. Kendell Airlines is the largest Australian regional airline. It is owned by Ansett Holdings Limited (AHL) which also owns and operates Ansett Australia (AA) and Ansett International Airlines. AHL and AA [] which was arranged by [] and [].

106. AHL is Australia's second largest airline. At the time of the transaction, it held a [] per cent domestic market share and had annual revenues in excess of AUD [] (approximately USD []). The airline is a member of the Star Alliance, one of the world's leading airline alliances.

107. At the time of the development of the pricing strategy for this airline, no USD benchmarks existed for Kendell or AHL and AA, []. EDC pricing largely depended upon the input of the lead arrangers [] and [] who had extensive experience in such transactions.

108. EDC's pricing was exactly the same as the other participants in the transaction. Indeed, all terms and conditions of this credit were shared on a *pari passu* basis by all the participants. None of the terms and conditions, including pricing in the public offering or the final agreement relied on EDC's participation. Contrary to Brazil's claim, EDC was a price taker, not a price maker in this transaction. The participating private commercial banks set the interest rates.

109. Accordingly, the Kendell transaction offers an excellent empirical standard against which to test the credibility of Brazil's assertions in its 31 July 2001 statement that EDC's financing below certain EETC related data (as selected by Brazil) is necessarily below market. According to Exhibit BRA-66, a "market spread" for the Kendell transaction should have been [] over US Treasury. However, the evidence shows that, by Brazil's own estimate, Kendell was able to arrange financing for that transaction in the commercial marketplace for [] less than that. The Kendell transaction proves that Brazil's construction of "market spreads" is simply not credible.

110. EDC was also invited to participate in the second Kendell transaction by [], the transaction's arranger. At that time, EDC concluded that the risks associated with the transaction were too great in relation to the total return and declined to participate. A commercial bank syndicate, led by [], ultimately provided the requisite financing.

IV. INVESTISSEMENT QUÉBEC

111. Most of the arguments Brazil makes in its 31 July 2001 statement regarding Investissement Québec (IQ) repeat arguments Brazil has made elsewhere and which Canada has already addressed. For example, Brazil contends that IQ has provided guarantees without charging a fee. This, as Canada has previously noted, is not correct.[36] Even when Brazil acknowledges that IQ has charged fees, as in the case of the Midway Airlines and Mesa Air transactions, it asserts that the pricing was simply [] basis points, whereas Canada has explained that the [] basis point fee is an up-front fee in addition to an annual fee of [] basis points. In its 31 July statement, Brazil does allege for the first time that CQC provided direct financing in the Midway transaction.[37] This is not correct. Brazil appears to have confused the equity guarantee with direct financing.

112. Brazil also argues, in its 31 July statement that the uniformity of IQ's fee is indicative of a failure to follow the market because "no market guarantor would charge the same fee to recipients with wildly varying credit ratings."[38] This assertion ignores the nature of the IQ guarantee and the [].[39] As Canada explained in its 26 July 2001 answer to the Panel's Question 47 as well as at paragraphs 67 and 68 of its Rebuttal Submission and in its answer to the Panel's Question 14, the [] does more than just greatly diminish IQ's risk exposure. In large part, the risk represented by the possible default of a particular aircraft purchaser is [], it is entirely appropriate that the fee charged to different purchasers would be the same.

V. CONCLUSION

113. Canada has demonstrated throughout these proceedings that EDC and Investissement Québec operate on a financially-self sustaining basis and provide products that are structured and priced commercially. At the request of the Panel, Canada has provided extensive documentation, much of it commercially sensitive, demonstrating clearly that EDC goes to great lengths to establish the appropriate terms and conditions for each transaction and that these terms and conditions are

[36] See Canada's Rebuttal Submission, para. 66 and Canada's Answer to Question 14, para. 7.
[37] Brazil's 31 July Statement, para. 119.
[38] Brazil's 31 July Statement, para. 23.
[39] [] (Exhibit CDA-65).

consistent with those which a borrower is able to obtain for a comparable transaction in the commercial markets. Canada provided this information despite Brazil's abject failure to present a *prima facie* case that any of EDC's Corporate Account transactions were not offered on market terms. In its 31 July oral statement, Brazil attempted to manufacture a case against these transactions, and against EDC, by misrepresenting and taking out of context the evidence that Canada provided in this and other disputes. As this submission demonstrates, Brazil's case against these transactions is entirely without merit and must fail. The evidence is overwhelming that these transactions were priced on terms no more favourable than those available to the recipients in the market.

114. Canada has also provided extensive evidence regarding the operations of IQ. Brazil said very little about IQ in its 31 July statement that it had not said previously and that Canada had not already refuted. Brazil's new arguments concerning IQ are either factually incorrect or fail to recognize that IQ's risk exposure is both limited and []. Brazil has offered no credible basis, in its 31 July statement or its previous submissions, for its claim that IQ guarantees are prohibited export subsidies. This claim must also fail.

ANNEX I

BRAZIL'S PRICING METHODOLOGY IN BRA-65 IS FLAWED

I. BRAZIL'S STATED METHODOLOGY:

"Brazil compared the spreads offered by Canada with the weighted-average of the spreads at which all EETCs issued by each airline were trading at the time of the Canadian offer."

There are several problems with this methodology outlined below.

Brazil's Methodology	Reasons Brazil's Methodology is Flawed	Recommended Approach
1. Use of All EETCs	The use of all EETCs tracked by Morgan Stanley Dean Witter (MSDW) has meant that non-airline EETCs have been included. These non-airline EETCs include []. Brazil violated its own stated methodology.	Only airline EETCs should have been considered.
2. Use of all Tranches Within an EETC to Create a Weighted Average Credit Spread	By their nature, EETCs are made up of several debt tranches, all with different credit ratings and terms. This has several implications. (i) It is inappropriate to compare tranches with credit ratings significantly different from the EDC financing. (ii) It is inappropriate to compare tranches with repayment terms significantly different from the EDC financing. (iii) It is inappropriate to compare tranches with loan-to-value terms significantly different from the EDC financing.	A pricing methodology must compare debt financing that is substantially similar to the loan being considered. Canada's methodology compares the EDC financing to [] A Note on EETC Leverage: EETCs may appear to have lower loan-to-value (LTV) ratios and therefore be less risky compared to bank financing. However, in the EETC market aircraft values are established by independent appraisal. In the bank market LTV ratios are established relative to aircraft price. Appraisal values tend to be higher than actual aircraft selling prices. Therefore on a net basis the total dollar amount being financed is almost equal between the two sources of financing. For example: EETC: aircraft appraisal $20 million * 70% LTV = $14 million financing Bank Loan: aircraft selling price $17.5 million * 80% LTV = $14 million financing
3. Use of EETC Pricing During 1996-1999	As Brazil correctly states at paragraph 62 of its 31 July statement, EETCs are a relatively new financial instrument for debt financing in the aircraft sector. The EETC market lacks liquidity (trading volume), which may in part explain why EETC pricing is are higher than other forms of commercial financing. There is a large gap between the EETC pricing and the pricing obtained from comparable corporate bond spreads and the Fair Market Curve spreads.	Canada's methodology incorporates []. The [] reflect pricing available in a liquid market and the [] pricing reflects pricing that is unbiased with regard to pricing that is negotiated with the []. Where Canada does show EETC pricing, it uses the tranche's pricing spread at the date the EETC was issued. This avoids any further distortion to the spread caused by trading in an illiquid market. However, this does not eliminate the pricing problem caused by an illiquid EETC market since the spread at issue was determined under the same conditions.
4. Use of one Pricing Source	The reliance on any one piece of research, in this case EETC spreads, to complete a pricing strategy can misrepresent the facts surrounding the pricing attributable to a given credit rating.	In order to reduce the reliance on any one pricing source Canada's pricing methodology incorporates [].

BRAZIL'S PRICING METHODOLOGY IN BRA-66 IS FLAWED

I. BRAZIL'S STATED METHODOLOGY:

"Brazil compared the spreads offered by Canada with an estimate of the likely spread for that transaction based on the average spreads for all EETCs in the year in which the transaction took place. For this comparison, Brazil took the average offering spreads from all EETCs issued in the year of each Canadian transaction as its starting point. We then added the impact of the credit rating of the [airline] based on Canada's ratings...this impact was calculated as plus or minus 15bps based on an analysis of all EETCs offered during the period 1996 - 1999"

There are several problems with this methodology outlined below.

Brazilian Methodology	Reasons Brazilian Methodology is Flawed	Recommended Approach
1. Timeline for Pricing EETCs	Brazil has attempted to compare pricing issued at one point in time with comparables from the future. It is normal practice in the debt markets to price a given transaction in the immediate present. This pricing may be based on comparables using historical information and an expectation of possible future economic changes. Actual pricing from the future is not available and could not be used by EDC when it issued its financing offers.	Market pricing is achieved by reviewing market benchmark data reflective of the transaction being considered. Data by its nature is historic and therefore only past transactions and currently available data can be used. In reviewing EETCs as a potential market benchmark, Canada considered EETCs that were issued within the past 120 days from the date of the EDC offer of financing. In reviewing [], Canada considered [] spreads available at the approximate date of the EDC offer of financing. In reviewing [], Canada considered [] at the approximate date of the EDC offer of financing.
2. Adjustment of EETC Spreads to Account for Credit Rating Differences	Canada agrees that the spreads reflected in pricing benchmarks of one credit rating class can be adjusted to estimate a corresponding spread to another credit rating. However, the EETC pricing being used by Brazil was flawed making any further adjustment to the data useless. These flaws are set out in the foregoing critique of BRA-65.	Canada's methodology attempts to use EETC tranches that are within [] of the rating assigned to the EDC loan. There is no attempt to manipulate each benchmark's pricing, but it is understood that there is a pricing difference (up or down) as a given debt product has its credit rating reduced or improved. Appendix 1 to Annex II illustrates how credit spreads increase as credit ratings worsen. Appendix 1 also provides the rating scale used by Standard & Poors (S&P) and Moody's Investor Service (Moodys).

ANNEX II

[]

Appendix 1

Credit Rating Correlation

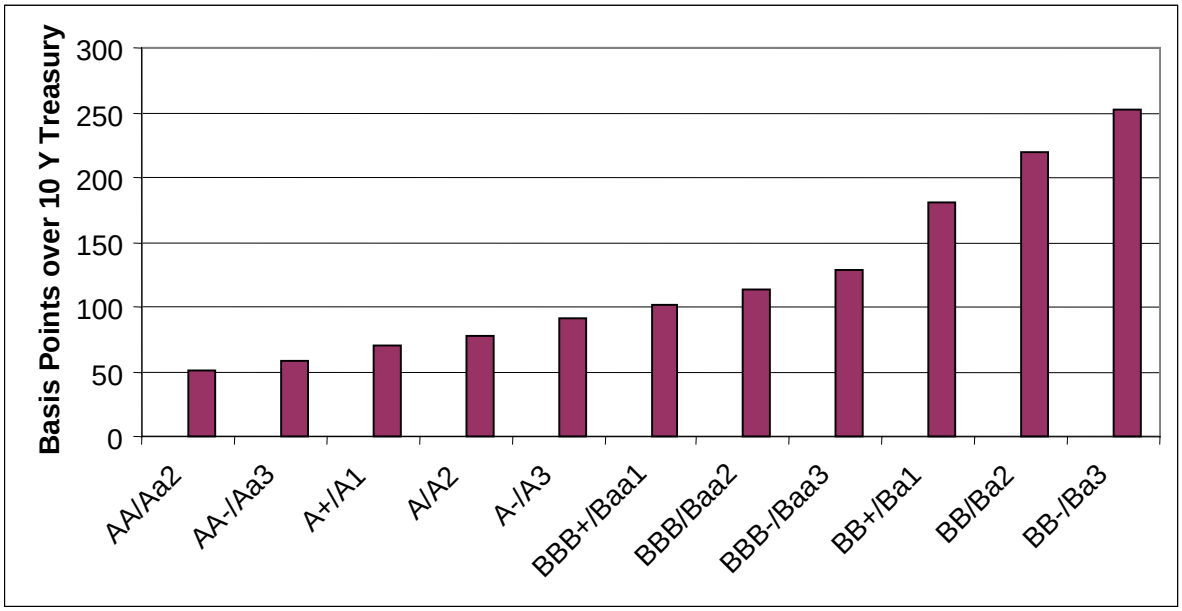
Standard & Poor's		Moody's
AA+	=	Aa1
AA	=	Aa2
AA-	=	Aa3
A+	=	A1
A	=	A2
A-	=	A3
BBB+	=	Baa1
BBB	=	Baa2
BBB-	=	Baa3
BB+	=	Ba1
BB	=	Ba2
BB-	=	Ba3

A Note on Split Ratings: It is not uncommon for a rated debt instrument (eg. EETC tranche) to have a split credit rating. This is where two rating agencies have given the same security different ratings where one rating is lower than the other. For example, S&P could provide a rating of BBB+ and Moody's could rate the same security one rating notch lower at Baa2. In such instances, the lower credit rating is likely to cause the debt instrument's yield over US T to be higher.

Industrial Indices (Bloomberg Fair Market Curve History) - August 14, 1998

Credit Rating (S&P / Moody's)	Industrial Spreads in bps over 10 Year U.S. Treasury
AA/Aa2	51
AA-/Aa3	58
A+/A1	70
A/A2	78
A-/A3	91
BBB+/Baa1	102
BBB/Baa2	113
BBB-/Baa3	129
BB+/Ba1	180
BB/Ba2	219
BB-/Ba3	252

Note: One of the main tenets of finance is the concept of risk and return. As the risk of return increases so does the required return. As the credit rating for a debt instrument decreases (eg. moves from AA to BB) the required spread over US T increases. The graph below illustrates the incremental spread for the Fair Market Curve - Industrial Index as one moves down the credit scale. As one moves from BBB to BBB- the incremental spread is 16bps.



Appendix 2

Comments on the Relevance of EETC Pricing

EETC's Exhibit Pricing Volitility

"Throughout our observation of spread behaviour among the different EETC baskets we have created out of our database, we found that in any given month it is not uncommon to observe spread "anomalies" that defy common logic. This is reconcilable with the notion that EETCs are complex securities whose spread behaviour cannot be fully explained by any single variable."

Salomon Smith Barney, *The EETC Trading Observer*, 9 May 2001, p. 16. (Exhibit CDA-80)

EETCs are Not Priced Consistently Even When They Are Priced At the Same Time

Airline / EETC Issue	Tranche / Coupon	MSDW* April 30, 2001 Tranche Spread (bps)	SSB** April 30, 2001 Tranche Spread (bps)	Difference (bps)
America West / 1998-1	A / 6.870% B / 7.120% C / 7.840%	205 270 300	215 290 320	10 20 20
Continental / 1997-1	A / 7.461% B / 7.461% C / 7.420%	170 230 220	165 215 215	-5 -15 -5
Northwest / 1994-1	A / 8.26% B / 9.36%	210 285	175 245	-35 -40
United Airlines / 2000-1	A1 / 7.783% A2 / 7.730% B / 8.030%	170 172 230	163 160 235	-7 -12 5
US Air / 1998-1	A / 6.850% B / 7.350% C / 6.820%	240 310 390	215 305 370	-25 -5 -20

*Source: Morgan Stanley Dean Witter, *EETC Market Update*, 7 June 2001, pp. 18-21. (Exhibit CDA-101)
**Source: Salomon Smith Barney, *The EETC Trading Observer*, 9 May 2001, pp. 37-41. (Exhibit CDA-80)

ANNEX B-13

RESPONSES OF CANADA TO ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(15 August 2001)

Following are Canada's answers to the Panel's 10 August 2001 additional questions to the parties:

Question 74

Please comment on Brazil's contention (in response to Question 56) that under the Bombardier offer there would be "significantly lower semi-annual payments" than under the Embraer offer. Please calculate the amount of semi-annual payments for both offers, assuming a loan amount of $1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, that 20 per cent of the loan amount would be for [].

1. Brazil's contention that under the Bombardier offer there would be significantly lower semi-annual payments" than under the Embraer offer, is not accurate. To assess Brazil's contention, the Panel has requested that the parties calculate a "semi-annual payment" on the basis of certain assumptions. However, this too poses problems, because a number of the assumptions proposed by the Panel are not valid.

2. The assumption of an identical interest rate may be appropriate, but the assumption of an identical loan amount is not. The total loan amount will necessarily affect the amount of semi-annual payments on that loan. The total loan amount will depend on the price of the aircraft, as well as the number of aircraft being financed. Thus, in order to assess Brazil's contention, one cannot ignore the [] under Embraer's offer. As Canada has pointed out previously, one would need to compare the Bombardier offer, which involves a loan on [] aircraft, with the Embraer offer, [], as assumed in the *Brazil – Aircraft* Article 22.6 arbitration.[1] [] As a result, the payments under the Embraer offer would be greater than under the Bombardier offer.

3. A number of other factors also make the comparison envisaged by the Panel untenable, and illustrate the problems with Brazil's contention. For example, Brazil's contention in its response to Question 56 is necessarily based on a leveraged lease structure rather than a direct loan structure. Under a leveraged lease, loan payments and the average life of the loan are structured to optimize the costs to the borrower and the benefits to the equity investors. There is a vast array of possible repayment profiles, both in terms of amount and timing, associated with any given average life constraint. Airlines and equity investors employ very sophisticated software models to calculate and optimize the costs and benefits associated with various aircraft financing proposals. Many variables factor into these calculations, including the average life constraints imposed by lenders. The

[1] Canada's Answers to the Panel's Question 56, 8 August 2001, para. 1, referring to *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*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000, para. 3.79.

repayment profile associated with loans made under a US Leveraged Lease structure can vary substantially between loans even when their average life constraints are the same.

4. Brazil has alleged in its response to Question 56, that the average life under Bombardier's offer is [] years. This is not correct. Bombardiers's offer permits a repayment profile that results in an average life of *up to* [] years, but this does not mean that the repayment profile chosen by Air Wisconsin under Bombardier's offer will have an average life of [] years. Often, airlines and equity investors will determine, on the basis of the software model they use, that they will achieve optimal benefits (i.e. the airline will achieve the lowest cost and the equity investor will achieve the highest benefit) under a repayment profile that will result in an average life lower than [] years. A lower average life constraint would result, on average, in higher periodic payments (e.g. the semi-annual payments assumed by the Panel).

5. Furthermore, unless the lender specifically requires principal payments to be made semi-annually, the amount of the loan payments in a leveraged lease structure would be very unevenly spread throughout the term and could result in no principal repayment in some years or, alternatively, periodic payments that are higher at the beginning of the term or at the end of the term. []

6. For all of the foregoing reasons, Brazil is incorrect in contending that the Bombardier offer would result in significantly lower semi-annual payments. For the same reasons, it is impossible to directly compare semi-annual loan payments under the two offers on the basis of the Panel's assumptions.

7. Nevertheless, in order to illustrate some of the problems with Brazil's contention and with the assumptions proposed by the Panel, Canada has sought to make the calculations requested by the Panel. Canada has asked for assistance from [] which, in its capacity as an advisor to airlines and equity investors, uses a software model of the sort described above.

8. Holding all other variables constant, Canada instructed [] to calculate the loan repayment profile for two offers, assuming an interest rate of 6 per cent, an average life constraint of [] years in one case and [] years in the other, and an identical loan amount of $1 billion in each case. Even this is problematic, and less than fully realistic, because the software models used to optimise payment structures calculate the economics of a transaction on an aircraft-by-aircraft basis rather than on the gross loan amount basis in the Panel's assumption. Canada did not ask [] to incorporate the Panel's assumption that, "[]", both because it is unclear what is meant by this assumption and how it might be incorporated into the calculation.

9. The results of the calculations provided by [] in its model (attached as Exhibit CDA-102) show very different repayment profiles for the two offers. During certain years, principal repayments may not be made at all. The calculations show that in some years, the payments of principal and interest would be higher under an offer with a [] year average life constraint than one with a [] year average life constraint. Although the payments under a $1 billion loan with the longer average life would be slightly lower on average ($52.6 million as compared to $53.1 million), because of the longer repayment term the airline would incur additional interest costs of some $90 million under the offer with a [] year average life constraint as compared to the offer with the [] year average life.

Question 75

Relating to Canada's answer to panel question 67, is Canada of the view that the showing of the "possibility", "probability" or "expectation" of the future Brazilian government support would be sufficient to satisfy a legal element of "official support" under the OECD Arrangement in respect of "matching" provisions?

10. Canada is not clear what the Panel means by a "legal element" of official support under the OECD Arrangement. However, if, as in this case, there is a well-founded basis for concluding that Embraer's offer was to be officially supported by the government of Brazil, that is sufficient to entitle Canada to make a matching offer under the OECD Arrangement.

11. In order to satisfy the requirements under the OECD Arrangement to match a non-Participant, one must respect the provisions of Article 53 of the OECD Arrangement, "Matching of Terms and Conditions Offered by a Non-Participant". Article 53 requires Participants to undertake the following actions: (i) to "make every effort to verify" official support, (ii) to "inform other Participants of the nature and outcome of these efforts", and (iii) to notify the other Participants.[2]

12. Article 53 does not require Participants to be completely certain that the initiating offer was officially supported. The drafters of the OECD Arrangement recognised that it may be impossible in a matching situation involving a non-Participant to be certain that the matched terms and conditions were officially supported because non-Participants are not subject to the notification and transparency requirements of the OECD Arrangement.

13. Instead, Article 53 requires Participants to "make every effort to verify" official support. At the end of this due diligence exercise, the Participant intending to match would be in one of the following three situations:

- The due diligence exercise would demonstrate that the initiating offer is not officially supported. In such a situation, there would be nothing to match.

    - The due diligence exercise would raise doubt as to whether the initiating offer is officially supported. Although Article 53 does not specifically address this situation, it is implicit that Participants use "good faith" when matching. This "good faith" test is consistent with the status of the OECD Arrangement as a "Gentlemen's Agreement". Proceeding with matching in this situation would not be in "good faith" and would thus be inconsistent with the OECD Arrangement.

    - The evidence obtained in the course of the due diligence exercise would lead to the conclusion that the initiating offer is officially supported, even though the existence of official support might not be established with 100 per cent certainty. Matching in this situation would be in "good faith" and would be consistent with the OECD Arrangement in general and the requirements of Article 53 in particular. Moreover, under the Arrangement, all other OECD Participants have an opportunity to provide their views on the appropriateness of the matching. This peer review discipline acts as a third-party check on Participants' use of matching.

14. In the Air Wisconsin transaction, Canada is in the third situation. Canada has explained how it made every effort to verify in good faith that Embraer's financing offer to Air Wisconsin was officially supported by Brazil.[3] Canada's efforts met the requirements of Article 53. The peer review discipline did not result in any comments by other Participants on Canada's matching notification or on the nature or outcome of its due diligence efforts. Furthermore, as described in Canada's answer to the Panel's Question 67, the evidence is very strong that Embraer's offer was to be officially supported by Brazil. Indeed, Embraer confirmed to Air Wisconsin that it expected its offer to be supported by the Government of Brazil, as described by Air Wisconsin in its letter of 7 August 2001 (Exhibit CDA-68).

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[2] Canada has fulfilled both the information and notification requirements of Article 53 of the Arrangement. See Rebuttal Submission of Canada, at para. 95.

[3] Most recently at paragraphs 72 – 74 of Canada's Second Oral Statement. See also Rebuttal Submission of Canada, paras. 83 – 94.

15. Therefore, because Canada undertook "every effort" within the meaning of Article 53 of the Arrangement to verify Brazilian official support, and because, as a result of those efforts, Canada had a well-founded basis for concluding that Embraer's offer was to be officially supported by the Government of Brazil, Canada was entitled to make a matching offer under the OECD Arrangement.

Question 76

In response to panel question 67, Canada states that "it is simply not credible that []." Does this mean that Embraer offered financing terms and conditions that were not available in the "market"? If so, could Embraer's offer be used as a "market benchmark" in determining the "benefit" issue? Please explain.

16. []

17. As Canada demonstrated in its 8 August 2001 answer to the Panel's Question 67, all of the evidence before the Panel points to the Brazilian Government's involvement in Embraer's offer. The only reasonable conclusion from the evidence before the Panel is that Embraer's offer was to involve Brazilian government support. That conclusion is reinforced by the fact that it is not credible that [].

18. Nevertheless, if the Panel does not consider that Embraer's offer involved or was to involve Brazilian government support, []. Such financing would be, by definition, on terms available in the market.

19. Accordingly, if the Panel considers that Embraer's offer involved Brazilian government support or was to do so, it is not a "market benchmark". However, if the Panel considers that [], the offer is a "market benchmark" in determining the "benefit" issue.

ANNEX B-14

COMMENTS OF CANADA ON RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(20 August 2001)

The following are Canada's comments on Brazil's responses to the Panel's Questions 54-62 and 73.

Question 54

In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

1. Brazil's response does not answer the Panel's question. Brazil seeks to distinguish between sales price and the price of financing but does not explain why the Panel's question does not apply to the price of financing terms. Canada notes that Brazil does agree that the market can be determined by comparing the financing terms of a transaction with the financing terms that a commercial institution would provide for a similar transaction. In the case of Air Wisconsin, [].

Question 55

If it is commercial practice to engage in transactions at a short-term loss for long-term commercial reasons, should such transactions be treated as "market" transactions? Please explain.

2. As Canada has noted, there is absolutely no evidence to support Brazil's speculation that [].

3. Even if Embraer had been engaging in such behavior, Brazil recognizes in its response to the question that "if it is the 'commercial practice' of a significant number of the sellers in a trade to sell below cost, then, arguably, the market has moved to that level." Presumably, how many sellers constitute a "significant number" will depend on the number of sellers in the market. In the regional jet aircraft market, where there are effectively only two players and one of them, Embraer, has approximately half of that market, the commercial practice by that one player will be "a significant number". In such an oligopolistic market, classical economic theory provides that where one of the main players lowers its price, whether or not it results in a short-term loss, that price sets the market, because the other main player is compelled to meet that lower price. In this situation, transactions at a short-term loss for long-term commercial reasons would be market transactions.

Question 56

Please analyse the significant elements of Embraer's second offer, and the Canada Account / Bombardier offer, to Air Wisconsin, and indicate how the significant elements demonstrate that such offers were, or were not, comparable.

4. Canada has replied to this question in its own answer to Question 56.

Question 57

Brazil has expressed concern regarding the use of indices of general industrial bonds. In particular, Brazil has asserted that such ratings do not take account of the fact that there may be different risks involved in an airline company as opposed to an industrial company. Why would such different risks not be dealt with by the fact that companies are rated, so that if an airline company is higher risk than an industrial company, it will typically be rated lower?

5. Brazil's response to this question highlights, to some extent, the difficulty in determining a single "market rate" for a transaction. As Brazil observes in the third paragraph of its response, even companies with the same credit rating could qualify for different financing spreads due to such things as collateral arrangements and competitiveness within the industry. As Brazil notes, these factors "are largely left to the discretion of the market."

6. Brazil contends that the different risks between airline companies and industrial companies are not necessarily reflected in the different ratings of the companies. It observes that:

> In the event of a change in the performance of a particular bond issuer or its industry, the market will react much more immediately than will the credit ratings agencies. The result will be a discrepancy between the spreads at which similarly rated companies in different industries may trade.

7. Brazil offers no explanation as to why similar considerations could not explain the differences in terms offered to airlines with different ratings on the basis of EDC's transaction-specific assessment of risk. By assessing the individualized risk of a particular airline in a specific transaction, EDC is able to take into account what Brazil seems to consider the inaccuracies inherent in more generalized credit risk assessments.

8. Much of Brazil's response to Question 57 turns on its assertion that smaller companies will not have access to financing at the same rates as larger companies, even when they have the same credit rating. This is incorrect. Ratings are not correlated to size. For example, an airline such as Southwest, with total revenues of USD 5.6 billion is rated A by Standard & Poors and A3 by Moody's. United, a much larger airline with total revenues of USD 19.3 billion has a sub-investment grade rating of BB+/Ba1.[1] Continental, with market capitalization of USD 2.9 billion is rated by Moody's as Ba2 but Northwest, with market capitalization of USD 2.3 billion is rated several notches lower at B1.

9. As Canada has previously noted, rating agencies, such as Moody's and Standard and Poor's (S&P), provide ratings at the request of and are paid for by the rated firm. Companies are willing to make this expenditure when they intend to seek financing in the public debt markets. The fact that a company is not publicly rated is not necessarily an indicator of any financial weakness or defect nor is it an indicator of the size of the company; it simply indicates that the company does not require public debt financing. Many large firms, including a number of large international airlines (such as Virgin and Singapore Airlines), carry no external rating. In such cases lenders must have an alternative method of assessing the financial risk of unrated companies. Banks such as Barclays Bank, ABN

[1] In its Second Oral Statement, Canada referred to Southwest as one of the smaller U.S. airlines, but obviously this is in relation to the other major U.S. airlines. Southwest is smaller than American, United, Delta, Northwest and Continental. Canada did not mean to suggest that Southwest was equivalent in size to some of the regional airlines, although as the Merrill Lynch commentary notes, some regional airlines, including Comair and ASA, may have equity valuations exceeding those of major U.S. airlines (Merrill Lynch, "Regional Airline Update: In Times of Economic Uncertainty, Look to Regional Airlines," 30 May 2001, p. 6 (Exhibit CDA-103)).

Amro, LloydsTSB and EDC utilize LA Encore/Moody's Risk Advisor automated rating software to generate internal ratings in these cases.

10. Though most regional airlines are not rated, it is false to assume that their ratings would necessarily be lower than the US majors. Indeed, as the following Merrill Lynch commentary notes, in many respects the regional airlines present a lower risk than their major airline counterparts:

> Historically, regional airlines have been consistently more profitable than their major counterparts. As such, the stock market has "awarded" them premium valuations vis-à-vis their major partners reflecting their materially better earnings performance and prospects. For example, ***SkyWest with only 23 RJs, 90 turboprops and $530 million of annual revenue has an equity market value of $1.7 billion – more than Alaska and America West's combined $1.1 billion!*** And those two major airlines generate annual sales, in aggregate of $3.8 billion, with a combined fleet of 233 large, jet aircraft!
>
> We can only speculate what Comair (and ASA) would be worth at current multiples. ***However, we do know that the implied equity value for 100% of ASA and Comair was roughly $3 billion based on Delta's purchase price a few years ago – which compares to Delta's current equity value of only $5.8 billion.***[2] [emphasis in original]

11. Although these comments are meant to reflect equity performance, the underlying facts are relevant to Brazil's assertions. The regional airlines have outperformed the majors in a number of key areas including revenue growth and, in terms of market capitalization, a number of the regional airlines – including Comair and ASA – are the same size if not larger than some of the US majors.

12. For all of these reasons, Brazil is wrong to suggest that regional airlines should pay more for financing than the major US airlines simply because of their sales revenues.

13. In the latter part of its response, Brazil again takes out of context Canada's discussion in the *Brazil – Aircraft* dispute of the relevance of EETCs.[3] Canada refered to EETC's to refute Brazil's contention that offering interest rates at the CIRR alone would never provide a material advantage to a borrower. Canada noted that certain EETC tranches are usually rated well above an airline's unsecured debt rating, but this, of course, does not mean that certain airlines cannot obtain financing in the market at interest rate spreads below those available to other airlines, depending on, among other things, the borrower's rating and the security of the debt.

14. It therefore is not at all surprising that ASA, which received an LA Encore generated unsecured rating of [], could obtain secured financing *in the market* at rates [] (see paras. 48 and 50 of Canada's Response to New Arguments in Brazil's Second Oral Statement) or that EDC would offer it financing at [], while [], which had a [] credit rating, would have a EETC tranche trading at [].

Question 58

What proportion of Embraer export sales of regional aircraft have not involved BNDES and / or PROEX support?

15. Brazil states that approximately []% of Embraer's export sales of regional jets to date have involved neither BNDES nor PROEX support. On the basis of information provided by Brazil in the

[2] *Id*.

[3] See also Canada's 13 August 2001 Response to New Arguments in Brazil's Second Oral Statement, paras. 24 and 29-34.

Brazil - Aircraft dispute and by Embraer to potential investors, Canada has considerable reservations regarding the accuracy of Brazil's response.

16. In the Article 22.6 Panel proceeding in *Brazil - Aircraft*, Brazil submitted an exhibit (Exhibit Br-A-15) entitled "Embraer Order Book as of 18 November 1999 – Subsidy Per Aircraft". Canada understands that all the numbers indicated in Exhibit Br-A-15 are in respect of export sales. That exhibit, (which is provided as Canada's Exhibit CDA-104) indicates that as of 18 November 1999, Brazil had committed to provide PROEX support on []. In the 22.6 Arbitration in *Brazil – Aircraft*, the arbitrators assumed a conversion of options into firm orders at a rate of 85%.[4] Applying the same conversion rate to the options referred to in Brazil's exhibit results in []. This would mean PROEX subsidies alone (i.e. without including BNDES financing) being provided on a total amount of [].

17. The order book included in Embraer's Prospectus of 12 June 2001,[5] indicates that as of that date, Embraer had firm orders (including aircraft already delivered) for 955 regional jets. Canada understands that all of those firm orders represent export sales.

18. A simple calculation demonstrates that the [] that would receive PROEX subsidies on the basis of Exhibit Br-A-15 (now CDA-104) represent approximately []. Even assuming a more conservative 50 per cent conversion rate of options into firm orders, the numbers in Exhibit Br-A-15 indicate that PROEX subsidies would be provided on []. This would represent approximately [] per cent of Embraer's export sales.

19. As indicated, these numbers are in respect of PROEX support alone. They do not take into account BNDES-exim direct financing which, according to Exhibit CDA-105,[6] represents approximately [] per cent of Embraer's backlog (in terms of value).[7] Thus, it is impossible for Canada to reconcile Brazil's response with the foregoing data on Embraer's order books.

Question 59

Brazil has argued that, in considering whether or not a benefit is conferred by Canadian support, the Panel should also consider the possibility of benefit to Bombardier. To what extent is the benefit to Bombardier different from the benefit to its customers? Could there be a benefit to Bombardier in the absence of any benefit to its customers?

20. Canada has addressed this line of argument at paragraphs 1 to 8 of its answer to the Panel's Question 44, and has no additional comments.

Question 60

In response to Question 25 from the Panel, Brazil asserted that it is seeking findings in respect of specific EDC / IQ transactions. Is that still Brazil's position?

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[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*, Decision by the Arbitrators, WT/DS46/ARB, adopted 12 December 2000, para. 3.79.

[5] Embraer Prospectus, 12 June 2001, pp. 74-75. (Exhibit CDA-105)

[6] *Id*., pp. 12-13.

[7] In the second Article 21.5 proceeding in *Brazil – Aircraft*, Canada put into evidence a Preliiminary Prospectus of Embraer, which stated, at p. 12, that, as of March 31, 2000, approximately 51.1% of Embraer's backlog (in terms of value) was subject to financing by the BNDES-exim program. (*Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW2, not yet adopted, Annex A-2, para. 13). The same Preliminary Prospectus also gave a 57.5% figure (p. 77).

21. Brazil's response to this question, is that its "challenge is to how the measures [Corporate Account, Canada Account and Investissement Quebec] are applied generally, the evidence of which is found in specific transactions." Brazil's response continues to obfuscate. Brazil seems to be asserting that it can challenge Canada's programs "as such" on the basis of how they are applied in specific transactions. It cannot do so.[8] Moreover, Brazil has still refused to state clearly if it is challenging any specific transactions "as applied". The Panel should find that it is not.

Question 61

If one assumes that the second Embraer offer to Air Wisconsin was not officially supported, and that the offer was available in the market, how would the Canada Account offer to Air Wisconsin confer a benefit on Air Wisconsin?

22. If, as the evidence strongly suggests, Embraer's offer was dependent on Brazilian government support, Canada bears the burden of showing that its offer in response was made on a matching basis. However, the question starts from the premise that the second Embraer offer to Air Wisconsin was available in the market. If the second Embraer offer to Air Wisconsin was available in the market, the burden is on Brazil to show that Canada's offer is more favourable than the second Embraer offer and is therefore more favourable than that available to the recipient in the market. Brazil has avoided answering the question as posed and has attempted instead, in the third paragraph of its response, to reverse the burden of proof. It has no legal basis for doing so.

Question 62

The second page of the [].

23. Canada has no comment.

Question 73

In Canada's answer to the Panel's question 56, with respect to repayment term, Canada argues that "[]". Please comment, taking into account Brazil's statement (in response to the Panel's question 56) that "[]".

Please also explain Brazil's contention that under the Bombardier offer there would be significantly lower semi-annual payments. Please demonstrate this, assuming a loan amount of $1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, that [].

1. For the reasons set out below, Canada disagrees with the methodology Brazil has used in its calculations and the conclusions it has drawn from them. Among other things:

- Having made its assertion with respect to semi-annual payments, Brazil now bases its calculations on monthly payments;

- As Canada explained in its answer to Question 74, Brazil's contention in response to Question 56 was necessarily based on a leveraged lease structure. However, Brazil has based its calculations in part on a direct loan structure;

[8] See Canada's Rebuttal Submission, para. 52.

- Brazil has arbitrarily assigned certain variables differently to Embraer's offer than to Bombardier's. This makes the payments under the Embraer offer seem lower and those under Bombardier's offer seem higher.

2. Brazil contended in its response to the Panel's Question 56 that under Bombardier's offer, the borrower would make significantly lower semi-annual payments. However, when asked by the Panel to explain its contention, Brazil has chosen to compare the two offers based on monthly blended loan payments in the case of the direct loan structure, and monthly lease payments in the case of the leveraged lease structure. Bombardier's offer required *semi-annual* blended loan payments under the direct loan structure, not blended monthly payments as assumed by Brazil in its calculations.

3. In its response, Brazil also makes reference to a "[]", for Canada's direct loan, which is also incorrect. As Brazil itself states in the second paragraph of its response to Question 73, "reference to an [] is generally required by lenders in a US leveraged lease structure; however, this is not required in a structure such as the straight loan." This comment is accurate. It applies to the [].

4. However, in the case of a US leveraged lease structure, the market practice is to allow the repayment profile to be "optimized" by the lessee and the equity investor (as described in Canada's response to question 74). In such cases an [] will be imposed to ensure repayment is made over an acceptable period of time.

5. In its response to Question 56, Brazil argued that there would be "significantly lower semi-annual payments" under Canada's offer. It made this assertion in the context of the difference in the [] between the two offers. As stated in paragraph 3 of Canada's response to Question 74, Brazil's contention is necessarily based on a [], for the same reasons outlined in paragraph 1 above. Accordingly, Brazil's comparison of the [] in its offer, with Canada's [] is not relevant.

6. Furthermore, it is highly unrealistic to assume that Air Wisconsin will choose to finance a significant number of aircraft (if any) under Bombardier's [] because it would wish to avoid the necessity of making the required [] down payment. The same is not true of the Embraer offer, which [], making the Embraer offer more generous in this respect.

7. Brazil's calculations of payments under the [] structure in the respective offers is also misleading. First, by making its comparison on the basis of monthly [] payments, Brazil has made it difficult for the Panel to compare the calculations provided by Canada and Brazil.

8. Second, as Canada explained in its response to Question 74, there is a vast array of possible repayment profiles under a US leverage lease structure and many variables factor into the optimization models employed in the industry. Interestingly, the calculations provided by Canada and Brazil were done using the same software model. However, while Canada held all other variables constant as requested by the Panel, and compared the repayment profiles by only changing the average life, Brazil did not hold all other variables constant.

9. For example, Brazil assumed [], compared to [] per cent for Bombardier's offer. Brazil also assumed a longer lease term for Bombardier's offer ([]) than for Embraer's ([]). Then it further constrained the average life under the Embraer offer to [], although it has stated that the correct constraint is []. Each of these factors have the effect of increasing the required payment under Brazil's offer and reducing the payments under Canada's offer, thus exaggerating the difference.

10. To illustrate the effect of what Brazil has done, Canada has calculated "monthly" lease payments under both offers. Canada has employed the same model used by Canada and Brazil, has assumed an average life of [] years for Bombardier's offer and [] for Embraer's offer and has eliminated the differential assumptions Brazil made regarding [].

11. Based on $1 billion loan amount, the result of these calculations (below) show a monthly rent payment of $[] for Bombardier's offer compared to $[] for Embraer's. The difference, $[], is much lower than the difference of $[] calculated by Brazil. On a per aircraft basis (assuming [] aircraft) the difference amounts to just $[] per month.

Brazil's Calculations With Lease Variables Held Constant

Embraer's offer	Bombardier's Offer
Loan amount: $1 billion Debt rate: 6% Debt Term: Average Life: Lease Term: Residual value: Monthly rent:	Loan amount: $1 billion Debt rate: 6% Debt Term: Average Life: Lease Term: Residual value: Monthly rent:

112. Brazil's manipulation underscores the difficulty in comparing the respective payments under the two offers and dispels Brazil's assertion that the difference is "significant". It also underscores Canada's point, in paragraph 3 of its answer to Question 74, that there is a wide range of variables that can affect the actual payments under each offer.

13. Brazil's contention regarding payment amounts ignores these variables, making the comparison envisaged by the Panel problematic. Focusing for comparison, as Brazil has done, on only one element of the offer, is an inadequate basis for comparing complex financing proposals. Although any such comparison is inherently flawed, Brazil has further undermined its assertion by adjusting some of these variables to exaggerate the difference in payments under the two offers.

ANNEX B-15

COMMENTS OF CANADA ON INTERIM REPORT OF PANEL

(26 October 2001)

SECTION 1

SUBSTANTIVE COMMENTS

Para. 7.18

The second to last sentence states that "the legal framework under which the Canada Account is operated has changed". This is not correct. The legal framework has not changed, as Canada explained in its oral response to a question by the Panel at the second meeting with the parties.

Para. 7.106

In the second line, "whether Canada Account" should read "whether Corporate Account".

Para. 7.145

In the last sentence, "… Canada assumes that because the Embraer offer was not supported by the Brazilian Government …" should be changed to "…Canada assumes that if the Embraer offer was not supported by the Brazilian Government …". This would more accurately reflect Canada's argument, which was made in the alternative to Canada's principal position that Embraer's offer was supported by the Brazilian Government.

Para. 7.147

In the fourth line, [].

Paras. 7.152 and 7.316

It is not correct that Canada Account (or Corporate Account) financing is only available for export transactions. In respect of both Corporate and Canada Account, EDC may, pursuant to the *Export Development Act* and the *Export Development Corporation Exercise of Certain Powers Regulations,* enter into "domestic financial transactions", as defined in the regulations, provided that in doing so, EDC is supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities.

Para. 7.160

The first sentence of paragraph 7.160 suggests, incorrectly, that Canada considered the Embraer offer to be a "derogation" from the *OECD Arrangement*. Canada did not refer to the Embraer offer as a "derogation". "Derogation" is a term of art used in the *Arrangement* to refer to breaches by Participants of Article 27 of the *Arrangement*, entitled "No Derogation Engagement For Export Credits". It is not possible for Brazil or Embraer to "derogate" from the Arrangement because

neither is a party to the Arrangement. Accordingly, Canada asks that the first sentence of paragraph 7.160 be changed to read: "Neither party disputes that the Embraer offer to Air Wisconsin is not consistent with the *OECD Arrangement* …"

Para. 7.231

In the fourth last sentence, it appears that "is not determined" should be "is determined".

Para. 7.247

On the basis of statements made by Canada in the first *Brazil - Aircraft* Article 21.5 proceeding, the Panel appears to have incorrectly understood that Canada regards the premium on regional aircraft as a static and definitive statement. Canada did not mean to infer that for all cases all lenders would always deem that credits secured by regional aircraft merit a premium of 20-30 bps over credits secured by large aircraft. Variations in pricing between similar but non-identical asset classes are dynamic and subject to change due to, *inter alia*, increased familiarity with various asset classes, supply and demand and geo-political events.

Para. 7.255

Canada did not, and does not, reject Brazil's observation that the FMC represents an average of current pricing levels of the bonds of a wide range of similarly rated companies. However, nor was it Canada's contention that the FMC should be the *sole* benchmark for pricing transactions if other benchmarks are available. In cases where no precise benchmarks exist, the FMC can be used to demonstrate general market trends for borrowers with similar ratings. Furthermore, as Canada noted,[1] information regarding specific terms and conditions (including pricing) offered by other financial institutions to individual regional airlines is often limited due to the confidential nature of such financing agreements. Such information may need to be obtained from the airlines themselves or other interested parties. In these cases, the FMC may also be used to assist lenders in validating an appropriate pricing level based on information provided by the interested parties based on previous benchmarks and general market trends.

Para. 7.276

On the basis of the [], the Panel has concluded, incorrectly, that EDC financing [] does not include an []. To clarify, the [] provides that the [] will include []. The [] further allows for the lowering of the fixed margin for credit risk identified in the [] on the authority of the President or Senior Vice President Finance and Chief Financial Officer. Thus, an authorized margin below the identified fixed margin is the [] for that transaction.

Para. 7.293

In the last sentence, "ASA" should read "Comair".

Para. 7.392, footnote 303

The footnote states that the existence of the IQ loan guarantee in the Air Wisconsin transaction only "came to light" in material provided to the Panel subsequent to the second substantive meeting. It suggests, incorrectly, that Canada failed to provide information when requested to do so by the Panel. In fact, the [] IQ loan guarantee is described in the details of the EDC offer, which Canada provided in the attachment to its 25 June letter to the Panel (see page 12 of the attachment).

[1] Canada's Response to New Arguments in Brazil's Second Oral Statement, 13 August 2001, para. 16.

Para. 7.387

It appears that the last word of the second last sentence, "excluded", should read "included".

Para. 7.402, footnote 309

The Panel's statement at footnote 309 is inaccurate. []

Paras. 7.403 and 7.404

As described at page 12 of the attachment to Canada's 25 June letter, the [].

SECTION 2

TECHNICAL RECTIFICATIONS	
PARAGRAPH	CORRECTION
	As a general comment, we note that foreign phrases (such as *de facto, prima facie, ex post* and *a fortiori)* have not always been italicized. In addition, we note that Article 21.5 Panel and Appellate Body reports have not been referred to in a consistent manner.
1.5, line 7	"panellists" should be "panelists".
3.1, item 2, line 1	"Panel" should be "panel".
3.1, item 7, line 1	"Investissement Québec" should be italicized.
7.3, item 1, line 1	The comma after "2" should be deleted.
7.15, line 2	"*Canada-Aircraft*" should be "*Canada – Aircraft*".
7.15, line 6	"terms" should be "term".
7.16, line 5	Add a period to the end of the quote.
7.17, lines 16/17	Emphasis added is indicated but not shown.
7.18, line 3	It appears that the word "subject" should be inserted immediately before "of".
7.29, line 2	"Investissement Québec" should be italicized.
7.39, line 8	"*EC – Bananas*" should be "*European Communities – Bananas"*
7.47, line 6	There is an extra space between "B" and "e" in "*Bed*".
7.48, line 2	"in light" should be "in the light".
7.53, line 2	"Investissement Québec" should be italicized.
7.63, line 2	Insert a comma following the word "subsidies".
7.63, line 4	Delete the word "whether".
7.71, line 2	As "ECAs" does not appear in the quotation, replace the parenthesis with square brackets. In addition, "with the *raison d'être* " should be "that have as the *raison d'être*".
7.76, line 3	As "ECAs" does not appear in the quotation, replace the parenthesis with square brackets or, in this instance, delete it. In addition, "with the *raison d'être* " should be "that have as the *raison d'être*".
7.82, line 3	"realised" should be "realized".
7.93, line 3, footnote 57	It appears that the reference to footnote 43 should be a reference to footnote 38.
7.107, line 7, footnote 65	It appears that the reference to footnote 43 should be a reference to footnote 38.
7.122, line 3, footnote 77	The reference should be to the First Written Submission of Canada.
7.125, lines 7 and 8	In the statement as it appears in Canada's Answer to Question 42, no square brackets around the "s" in line 7 are required. Further, in line 8, a comma should be inserted after the word "support".
7.130, line 4	"panel" should be "Panel".
7.131, last line, footnote 89, lines 3, 4 and 7	In line 3, "in this standard" should be added after the word "use". In line 4, the quotation marks around "ensure" and "future" should be single rather than double. In line 7, the word "unknowable" should be inserted between "the" and "future".
7.134, line 5	"organisations" should be "organizations".
7.135, line 10	The word "limited" should be inserted before the word "exception".
7.141, line 2	The word "that" should be inserted after the word "stated". In addition, the comma after the word "loan" should be inside the quotation mark.
7.147, line 8, footnote	The reference should be to Exhibit CAN-68.

TECHNICAL RECTIFICATIONS	
PARAGRAPH	CORRECTION
105	
7.149, line 4	"per cent" should be "%".
7.153, line 3, footnote 114	"Exhibit BRA-16" should be in brackets.
7.151, last line	The word "to" should be inserted before "respond to international business…".
7.152, line 4	The word "to" should be inserted before "respond to international business…".
7.152, line 6	The word "was" should be in square brackets.
7.164, line 8, footnote 126	"47b)" should be "47(b)".
7.168, last line, footnote 136	The footnote does not note that the emphasis was included in the original.
7.175, line 6	The word "the" following "undercut" should be deleted.
7.184, line 8	The word "was" should be in square brackets.
7.184, last line, footnote 148	EDC 2000 Annual Report is Exhibit BRA-22.
7.185, line 1	Quotation marks should follow the word "contribution".
7.197, lines 9, 10 and 11	The words "customisation" and "organisation" on these lines should be "customization" and "organization".
7.206, line 4, footnote 164	The footnote does not note that the emphasis was included in the original.
7.207, lines 21 and 28	In line 21, "per cent" should be "%". In line 28, "capitalisation" should be "capitalization".
7.210, line10, footnote 172	"1997" should be inserted before "Shadow Bond…".
7.218, line 5 and 7.219, line 13	The comma after the word "conservative" should be inside the quotation mark.
7.218, last line, footnote 177 and 7.221, line 6, footnote 179	The reference should be to Comments of Brazil on Canada's Response to New Arguments in Brazil's Second Oral Statement.
7.236, last line, footnote 187	The footnote does not note that the emphasis was included in the original.
7.243, line 6, footnote 196	The footnote does not note that the emphasis was included in the original.
7.275, line 3	The word "to" should be replaced with "for".
7.281, line 4	"the [] banks" should be "[t]he [] banks".
7.282, last line	There should be a period inserted at the end of the sentence.
7.302, lines 6 and 7	"per cent" in both lines should be "%".
7.304, line 6, footnote 249	"[t] Joint" should be "[t]he Joint". There should be quotation marks after the word "Facility". In line 4, the word "financing" should be "pricing".
7.313, line 1	The word "was" should be in square brackets.
7.315, line 4 and 7.316, line 4	The word "to" should be inserted before the word "respond" in both instances.
7.316, line 6	The word "was" should be in square brackets.
7.329, line 4, footnote 265, line 4	Exhibit CAN-65 should be in brackets.
7.334, line 2, footnote 266	There should be a quotation mark after "guarantees".

TECHNICAL RECTIFICATIONS	
PARAGRAPH	CORRECTION
7.358, line 10	Add a space to "toCCC".
7.366, line 11	The word "anticipated" was emphasized in the Appellate Body Report.
7.374, line 15	"penalise" should be "penalize".
7.380, line 9, footnote 297	The reference should be to para. 9.340.
7.385	Brazil's original comment references Canada's exhibits as "Cda-XX", whereas the references in the quote are to exhibits "Can-XX".
7.385, line 32	"95 per cent" should be "95%".

ANNEX B-16

COMMENTS OF CANADA ON COMMENTS OF BRAZIL ON INTERIM REPORT OF THE PANEL

(2 November 2001)

Canada offers the following responses to three of Brazil's comments on the Interim Report of the Panel. The responses are keyed to the numbers used by Brazil in its 26 October 2001 submission.

Comment 4, re. para. 7.221

Brazil suggests that it was not using data in the same manner, or "exactly the same manner" as Canada did in the *Brazil – Aircraft – Second Article 21.5* proceeding. However, as the Panel notes in paragraph 7.221, Brazil twice cites its use of the same data in the same manner as Canada:

> Thus, in April of this year, Canada considered the highest-rated EETC tranche to be a "conservative relative benchmark when compared against the spreads required for financing regional aircraft." Now that its own transactions are being measured against this standard, however, Canada describes the use of this benchmark as "fundamentally flawed."[1] [emphasis added]

In addition, Canada recalls that Brazil noted a number of times in its oral responses at the second meeting with the parties that it had used the same data as Canada in the same manner as Canada had.

Brazil also comments in respect of paragraph 7.221 that: "it would be inaccurate for the Panel to imply that Canada has never previously used weighted average EETC spreads as a benchmark." However, that is not what paragraph 7.221 says. The last sentence of the paragraph states that: "Canada has not sought to rely (either in these proceedings, or in *Brazil – Aircraft – Second 21.5*) on the weighted average spreads of all EETC tranches." [emphasis added]

Comment 5, re. para. 7.226

Canada opposes the addition of a footnote to paragraph 7.226 as requested by Brazil. The comparison of Brazil's submission, at the Panel's request, of details concerning the Embraer offer to Air Wisconsin, with EDC's lack of access when pricing a deal to confidential information on the commercial financing of Bombardier aircraft is neither analogous nor appropriate. Moreover, EDC's arm's length relationship with Bombardier stands in contrast to the Brazilian government's position as a major shareholder in Embraer (including the so-called "golden share") and its participation on Embraer's Board of Directors.[2]

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[1] Comments by Brazil on Canada's Submission of 13 August 2001, 20 August 2001, para. 15. (Canada notes that the Interim Panel Report incorrectly cites this as "Comments of Brazil on Responses of Canada to Questions from the Panel Following the Second Meeting of the Panel".)

[2] Exhibit CAN-67, pp. 64, 66 and 72-3.

Comment 10, re. para. 7.352 (footnote 278)

Contrary to Brazil's comments, the Panel's statements in footnote 278 are accurate. Investissement Québec (IQ) did not provide financing to Midway. Brazil attempts to equate equity participation with "financing" and alleges that CQC was an equity participant in the Midway transaction. This is not correct. Neither IQ nor CQC were equity participants in the Midway transaction. Canada's confirmation of the accuracy of the Panel's statements in footnote 278 is offered without prejudice to the distinct issue of whether equity participation by IQ or CQC would fall within the terms of reference of the Panel, given the wording of Brazil's claim 7. However, the lack of IQ or CQC equity participation makes this issue moot, and the Panel does not have to decide it.

ANNEX C

Third-Party Submissions

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ANNEX C-1

THIRD-PARTY SUBMISSION OF THE EUROPEAN COMMUNITIES

(22 June 2001)

1. 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*") as well as the Understanding on Rules and Procedures concerning the Settlement of Disputes (the "DSU").

2. 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 European Communities considers its close involvement in the work of this Panel to be particularly important.

3. The European Communities trusts that the parties will ensure that all documents submitted to the first meeting of the Panel will also be sent to the third parties, as required by Article 10.3 of the DSU. It also wishes to express its readiness to comment further on any of the legal issues arising in this case by answering any questions which the Panel may wish to put.

2. Preliminary Issues - Scope of this Proceeding

4. The European Communities has comments on the two preliminary issues raised by Canada:

- Whether allegations involving non-compliance with a previous DSB recommendation must obligatorily be brought before an Article 21.5 compliance panel;

- The alleged inconsistency of Brazil's claims with Article 6.2 of the DSU

2. Whether allegations involving non-compliance with a previous DSB recommendation must obligatorily be brought before an Article 21.5 compliance panel

5. In its preliminary submission of 18 June 2001, Canada argues that certain of Brazil's claims (claim 1 in part, claims 2 and 3 in their entirety) are inconsistent with Article 21.5 of the DSU since they are related to "issues of compliance".

6. Canada claims that Brazil's claim 1 is in part a claim concerning compliance because it refers to the allegation that

> [e]xport credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and *continue to be* prohibited export subsidies within the meaning of Articles 1 and 3 of the [Subsidies] Agreement [italics added].

7. It is because of the words in italics in this claim that, according to Canada, this claim is a complaint about compliance.

8. The European Communities does not consider this reading of Brazil's claim 1 to be compelling. A claim of this nature could easily be made even if there had been no prior panel procedure. The European Communities therefore does not believe that Canada's objection against this claim is justified.

9. It is true that Brazil's claim 2 contains an allegation that

> Canada has not implemented the report of the Article 21.5 panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

10. This claim appears to refer as a legal basis to an adopted panel report rather than to a provision of any of the covered agreements. The European Communities therefore considers this claim to be inadequate for purposes of Article 6.2 of the DSU which requires the complainant to

> provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.

11. As the standard terms of reference in Article 7.1 of the DSU demonstrate, the name of the covered agreement(s) cited by the parties to the dispute must be known at the time the request for the establishment of a panel is considered by the DSB. The closed list of covered agreements appears in Appendix 1 of the DSU, and a panel report in an earlier dispute, even once adopted, does not amount to a covered agreement. For these reasons, the European Communities is of the view that Brazil's claim 2 is indeed inadequate, albeit for reasons different from the ones invoked by Canada.

12. By contrast, Brazil's claim 3 does quote Articles 1 and 3 of the Subsidies Agreement which is a covered agreement under Appendix 1 of the DSU. This claim does therefore not suffer from the same inadequacy as Brazil's claim 2. Thus, the issue raised by Canada appears to be relevant at least in the context of this claim.

13. The European Communities is not convinced by Canada's argument that Article 21.5 of the DSU is the only provision under which an issue that arises in the context of compliance can be raised under the DSU. It is true that the terms of Article 21.5 of the DSU are not of a purely hortatory nature when it requires the parties to the dispute by the auxiliary "shall" to have recourse to "these dispute settlement procedures, including wherever possible resort to the original panel".[1] However, this "shall" relates, in the view of the EC, to the use of the original panel once the option of an Article 21.5 panel has been chosen and not to the use of the Article 21.5 procedure.

14. Article 21.5 of the DSU provides for a special accelerated procedure which the complainant in the original dispute has the right to resort to. However, nothing in the DSU appears to stand in the way to resort instead to an ordinary panel established under Article 7 of the DSU. Where a

[1] It is the position of the European Communities that the words "these dispute settlement procedures" refer to consultations, panel procedure and appeal, but not to arbitration under Articles 21.3(c) or 22.6 of the DSU[1]. The European Communities does not see how recourse to an ordinary dispute settlement procedure including consultations, normal panel proceedings and the possibility of an appeal would conflict with the prescripts of Article 21.5 of the DSU. The main reasons for the EC's position that recourse to arbitration procedures under Articles 21.3(c) and 22.6 of the DSU are not in line with the requirements of Article 21.5 of the DSU is that these arbitration procedures have strictly limited terms of reference, are not subject to appeal and, at least in the case of an arbitration procedure under Article 22.6 of the DSU, are not available at the request of the complaining party. None of these considerations applies under the circumstances of the present case.

complainant mentions a covered agreement as the legal basis for its complaint, as is the case in Brazilian claim 3, the fact that an earlier panel dealing with a dispute between the same parties has already dealt with the issue might become relevant in the context of a legal argument based on the concepts of *res iudicata* or litispendence. That is however apparently not the objection raised by Canada. That Brazil preferred an ordinary dispute settlement procedure over the accelerated procedure under Article 21.5 of the DSU does not prejudice Canada's procedural position nor is it in conflict with the prescripts of fairness of the procedure or Article 23 of the DSU.

15. Finally, the European Communities would observe that, since Article 21.5 DSU applies equally to the straightforward compliance and cases where measures taken to comply with a previous DSB recommendation are alleged to be inconsistent with the covered agreements, the position taken by Canada would mean that the latter category of cases must also obligatorily be brought before an Article 21.5 panel.

2.1.1. The alleged inconsistency of certain of Brazil's claims with Article 6.2 of the DSU

16. In its preliminary submission of 18 June 2001, Canada argues that Brazil's claims 1, 2, 5 and 7 are inconsistent with the requirements of Article 6.2 of the DSU.

17. The European Communities has consistently held that Article 6.2 of the DSU is, in combination with Article 7.1 of the DSU, a fundamental provision with regard to the delimitation of the terms of reference of a panel that have multiple functions for the settlement of disputes under the auspices of the WTO. More particularly, Article 6.2 of the DSU serves the purpose of indicating both to the respondent and to the third parties what is the subject matter of the dispute and where are the outer limits of such dispute. This is of fundamental importance in order to enable the respondent to understand the complaint it has to answer and for third parties in order to make an informed decision about their participation in the dispute. This provision thus serves the requirements of the fairness of the procedure, as the Appellate Body stated in a large number of cases, starting from *European Communities – Bananas.*[2]

18. The European Communities is therefore of the view that this provision should be strictly observed by complaining parties in order to allow both the respondent to prepare its defence and third parties to participate in a meaningful manner in the dispute settlement procedure. Loosely worded requests for the establishment of a panel, such as the catch-all clause "including, but not limited to" to describe the subject matter of a dispute have therefore rightly been held to fall short of the minimum requirements for a request for the establishment of a panel.[3]

19. The European Communities sympathises with Canada's difficulties in the present case to identify the subject matter of the dispute on the basis of the Brazilian claims 1, 2, 5 and 7. The identification of these claims in Brazil's request for the establishment of a panel appear at first sight to be worded too vaguely as to allow a clear identification of the subject matter of the dispute. Of course, it is necessary to read these claims together with the introductory paragraphs of the request for the establishment of a panel. In the first sentence of the first introductory paragraph, Brazil does indeed refer to its consultation request with regard to export credits and loan guarantees for regional

[2] Cf. Appellate Body report on *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, doc. WT/DS27/AB/R of 9.9.1997, para. 142.

[3] Cf. Appellate Body report on *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products*, doc. WT/DS50/AB/R of 19.12.1997, para. 90 ("the convenient phrase, 'including but not necessarily limited to', is simply not adequate to 'identify the specific measure at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly' as required by Article 6.2 of the DSU").

aircraft provided by or through Canada Account, the Export Development Corporation (EDC), or the province of Quebec.

20. It thus appears that Brazil is limiting the subject matter under dispute, by the reference to its request for consultations in the present dispute, to export credits and loan guarantees provided by or through clearly identified Canadian agencies. It appears to the European Communities that the introductory paragraphs of the request for the establishment of a panel in the present case also govern the claims developed under Nos. 1 to 7 of that request.

21. In the EC's view, the question before the Panel is therefore whether claims 1, 2, 5 and 7 of the request for the establishment of a panel, read in conjunction with the introductory paragraphs of that request, are sufficiently specific to allow Canada as the respondent to prepare its defence and the third parties to participate in the present proceedings in a meaningful way. The European Communities does not believe that documents relating to other dispute settlement procedures between the same parties would be a relevant source of information for this purpose as long as they are not specifically cross-referenced in the request of the establishment for a panel in the present dispute.

22. On this understanding, the European Communities proposes to read claim 1 as follows:

> Export credits, including financing, loan guarantees, or interest rate support by or through Canada Account *for regional aircraft* are and continue to be prohibited export subsidies within the meaning of Article 1 and 3 of the Agreement.

23. The words in italics in this rephrased claim are taken from the first sentence of the first introductory paragraph. In the view of the EC, this delimitation of the claim gives it some more precision than may appear at first sight. The question remains however whether this additional precision is sufficient "to identify the specific measure at issue" and "to present the problem clearly", as required by Article 6.2 of the DSU.

24. The European Communities has serious doubts that claim 1, even when redrafted as proposed in the preceding portion of this submission, identifies a "specific measure" as required and matches the additional requirement to "present the problem clearly". The safest way to identify a specific measure is to either attach the text of the contested measure to the request for the establishment of the panel or, in the alternative, to refer to a publicly accessible source where the text of the measure can be found. If both these possibilities are not chosen, at the very least the features of the measure must be summarised in such a way that there can be no doubt concerning the identification of the measure. These features should include at the very least a description of the substance of the contested measure, the acting persons or agencies, the time when the measure was allegedly taken and the affected products or industries. The European Communities believes that Brazilian claim 1 fails to meet this minimum standard with regard to the identification of the specific measure at issue.

25. With regard to Brazilian claim 2, apart from the fact that it does not refer to a legal basis in any of the covered agreements (as discussed above), no specific measure is identified where Brazil claims that Canada "has not implemented the report of the Article 21.5 panel". While the additional elements contained in the introductory paragraphs of the request for the establishment of a panel in the present case may help to understand that the report of the Article 21.5 panel to which Brazil refers is the panel report concerning Canadian export credits and loan guarantees for regional aircraft[4], it is not clear what is the specific measure that Canada has omitted to take although it had an obligation to act. In a case of an omission to act, it will usually not be possible to identify the measure which should have been taken by attaching its text physically to the request for the establishment of a panel or by a reference to a public source. However, it is in practically all cases possible to identify a

[4] Panel report on *Canada – Measures Affecting the Export of Civilian Aircraft*, doc. WT/DS70/RW.

measure that purportedly served the purpose of carrying out the legal obligation to act, but that in the view of the complainant is not sufficient to fulfil such obligation. Even where that would not be the case, the complainant is always able to summarise the main features of the measure that the respondent allegedly failed to take in spite of a legal obligation to act in such a way that the specific measure at issue is sufficiently identified for the purposes of Article 6.2 of the DSU. For instance, the complainant could claim that the respondent failed to withdraw a clearly identified export subsidy although it had an obligation to do so. The European Communities is not convinced that Brazilian claim 2 in the present case meets this minimum standard.

26. Brazilian claim 5 is virtually identical with Brazilian claim 1, except that the Canadian agency mentioned here is the EDC (Export Development Corporation) and that the words "and continue to be" have been omitted from claim 5. The conclusions that the European Communities has drawn for claim 1 are thus in the view of the European Communities also applicable to claim 5.

27. Brazilian claim 7 refers to *Investissement Québec* and is for the rest largely identical with claims 1 and 5. The conclusions that the European Communities has drawn for claim 1 are thus in our view also applicable to claim 7.

28. For the above reasons, the European Communities shares the concerns raised by Canada in its preliminary submission of 18 June 2001 with regard to Article 6.2 of the DSU. The European Communities notes that Canada has made the effort of drawing Brazil's attention to the shortcomings of its request for the establishment of a panel in the present dispute, and notes that Brazil has not responded positively to Canada's request to remedy these shortcoming prior to filing its first written submission. The European Communities therefore considers that Canada's rights of defence and the third parties' ability to clearly understand the purview of the present dispute have been seriously curtailed. The Panel should therefore come to the conclusion in the preliminary ruling requested by Canada that Brazil's claims 1, 2, 5 and 7 are not properly before it.

3. Substantive Legal Issues

29. There are a number of substantive legal issues on which the European Communities wishes to comment. These are:

- ➢ The distinction between mandatory and discretionary measures and its relevance in subsidy cases;
- ➢ The meaning of Article 1.1(a)1(iii) of the *SCM Agreement*;
- ➢ That "matching" is covered by the safe haven in the second paragraph of item (k) of the Illustrative List in Annex 1 of the *SCM Agreement*.
- ➢ Guarantees are also covered by the *OECD Arrangement*

30. These issues will be considered in turn.

3.1 The distinction between mandatory and discretionary measures and its relevance in subsidy cases

31. Canada lays great stress on the argument that since the contested programmes (EDC export credits and guarantees and *Investissement Québec*) are not mandatory – in the sense that that terms is used in WTO/GATT case law – the Panel may only consider specific instances in which these programmes have been applied.

3.1.1 There is no general principle preventing dispute settlement in relation to discretionary legislation

32. The European Communities contests that there exists in WTO law any *general* requirement that non-mandatory legislation cannot be the subject of dispute settlement. It considers that the scope of WTO obligations and the possibilities for invoking them against measures maintained by Members must be determined on the basis of the ordinary meaning of their text read in context and in the light of their object and purpose. WTO obligations are not to be restricted by some supposed overarching principle for which there is no basis in the text.

33. The European Communities would refer the Panel in this connection to the panel report in *United States– Sections 301-310 of the Trade Act of 1974*.[5] In paragraph 7.53 the panel in that case stated that:

> Despite the centrality of this issue in the submissions of both parties, we believe that resolving the dispute as to which type of legislation, *in abstract*, is capable of violating WTO obligations is not germane to the resolution of the type of claims before us. In our view the appropriate method in cases such as this is to examine with care the nature of the WTO obligation at issue and to evaluate the Measure in question in the light of such examination. The question is then whether, on the correct interpretation of the specific WTO obligation at issue, only mandatory or also discretionary national laws are prohibited. We do not accept the legal logic that there has to be one fast and hard rule covering all domestic legislation. After all, is it so implausible that the framers of the WTO Agreement, in their wisdom, would have crafted some obligations which would render illegal even discretionary legislation and crafted other obligations prohibiting only mandatory legislation?[6] Whether or not Section 304 violates Article 23 depends, thus, first and foremost on the precise obligations contained in Article 23.

34. The European Communities agrees with this approach. It would add that the pretended principle that discretionary measures may not be subject to dispute settlement as such is further contradicted by the terms of Article XVI:4 of the *WTO Agreement* which reads:

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

35. This provision must be given meaning and this meaning can only be that Members must do more than ensure that no specific WTO-inconsistent action is taken – they must also ensure that their laws do not specifically allow or envisage WTO-inconsistent action. This new principle introduced

[5] Report by the Panel on *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, 22 December 1999 (*US – Section 301*).

[6] The Panel further reasons in a footnote as follows:

> "Imagine, for example, legislation providing that all imports, including those from WTO Members, would be subjected to a customs inspection and that the administration would enjoy the right, at its discretion, to impose on all such goods tariffs in excess of those allowed under the schedule of tariff concessions of the Member concerned. Would the fact that under such legislation the national administration would not be mandated to impose tariffs in excess of the WTO obligation, in and of itself exonerate the legislation in question? Would such a conclusion not depend on a careful examination of the obligations contained in specific WTO provisions, say, Article II of GATT and specific schedule of concessions? "

with the *WTO Agreement* is a fundamental one.[7] Because it is laid down in the basic agreement of the system, it covers the whole set of the annexed agreements, whether or not they may contain specific expressions of the same principle. Furthermore, by virtue of Article XVI:3 of the *WTO Agreement*, it is a superior rule to provisions in the annexed agreements.

3.1.2 Whether discretionary subsidy programmes can be subject to dispute settlement

36. In the light of the above, the European Communities considers that the question of whether discretionary subsidy programmes can be subject to dispute settlement must be determined on the basis of terms of the *SCM Agreement.*

37. The first comment that it would make in this regard is that the *SCM Agreement* applies to both subsidy programmes and individual subsidy grants. This is already apparent from the repeated references to "programmes" in the *SCM Agreement*, in particular in Article 2.

38. In connection with export subsidies, the European Communities would point out that Article 3.2 of the *SCM Agreement* provides that:

> A Member shall neither grant nor maintain subsidies referred to in paragraph 1.

39. For the EC, this means that Members may neither make the *grant* of a subsidy contingent upon export performance nor *maintain* any subsidy programme that specifically envisages that subsidies may be granted contingent upon export performance, even where the grant is discretionary. The reason for this clarification is clear. If it were otherwise, Members would be able to adopt export subsidy programmes along the lines of

> The minister may reward companies for exceptional export performance with grants of up to $X% of turnover as he considers appropriate.

40. An exclusion of discretionary measures from the *SCM Agreement* would make such laws unattackable. There would be little point in attacking individual grants as and when they occur since they will already have happened by the time DSB recommendations can be adopted.

41. The findings of the panel report in *Canada – Aircraft*[8] (which, in any event, was not reviewed by the Appellate Body on this point), is not of any guidance in the present case in view of the context in which the panel's reasoning occurs. The panel was examining whether there were any subsidies in preparation for examining whether they were *de facto* export contingent and therefore prohibited. Even if the *Canada – Aircraft* panel's overall conclusion may be correct, its reliance on the discretionary/mandatory distinction to arrive at its conclusion appears misplaced and inappropriate.

3.2 The interpretation of Article 1.1(a)(1)(iii) of the *SCM Agreement*

42. Brazil attempts to argue that EDC activities can generally be considered to be export subsidies because they involve situations where:

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[7] "As a general and fundamental obligation imposed on all WTO Members, Article XVI:4 of the Marrakesh *Agreement Establishing the World Trade Organization* (the "*WTO Agreement"*) requires that each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the *WTO Agreement*." (see *Japan - Taxes on Alcoholic Beverages*, Arbitration under Article 21(3)(c) of the Understanding on Rules and Procedures Governing the Settlement of Disputes, WT/DS11/13, 14 February 1997, para. 9).

[8] Report by the Panel on *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, 14 April 1999, at paragraph 9.127.

> a government provides goods or services other than general infrastructure, or purchases goods;

within the meaning of Article 1.1(a)(1)(iii) of the *SCM Agreement.*

43. Brazil's argument appears to the European Communities to go too far and is probably to a large extent irrelevant. The European Communities has the following brief observations to offer:

44. First, the European Communities understands that this case concerns services offered to export customers of Canadian companies, which may indirectly benefit Canadian exporters. Items (k) and (j) of Annex 1 to the *SCM Agreement* expressly bring such measures into the scope of Article 3.1 *SCM Agreement*. Such services to purchasers are to be distinguished from services to exporters, which EDC also apparently provides but which call for a different analysis (not least because they do not fall under Items (k) and (j) of Annex 1 to the *SCM Agreement.*

45. The European Communities does not consider that Article 1.1(a)(1)(iii) of the *SCM Agreement* should be interpreted so widely as to render any government supplied service a subsidy when it has an economic value.

46. For the European Communities it is clear that Article 1.1(a)(1)(iii) of the *SCM Agreement* only brings into the scope of "financial contribution" supplies of services for less than full consideration. It is only in such cases that a government can be considered to have "contributed" anything that can be considered "financial".

47. Brazil's approach would transform all government services into subsidies. In many areas, including export credits and guarantees, governments are often able to offer something that commercial operators do not, or are able to offer it at a better rate, for example, because of some organisational or informational advantage. The European Communities does not consider that the *SCM Agreement* was intended to make all of these services subsidies, but to do so only when they are offered at a cost to the government – that is in the form of a financial contribution.

48. Even if this approach were not followed, it would still be necessary to consider whether the supply of these services confers a benefit. A benefit cannot be deduced from the fact that the recipient voluntarily accepts or seeks the services which it pays for. The Appellate Body has made clear that a benefit must be established by comparing the conditions on which the financial contribution is made with some relevant benchmark.[9]

49. Guidance for the interpretation of the concept of benefit is found in Article 14 of the *SCM Agreement*. Paragraph (d) relates to the supply of goods and services and provides that there is a benefit where the supply is for "less than adequate remuneration". It goes on to provide that this is to be assessed on the basis of "prevailing market conditions".

50. In the area of government services such as export credits and guarantees, governments are often the only suppliers able to offer these services. In these cases, the "prevailing market conditions" (the relevant benchmark) can only be the conditions on which equivalent services are offered by the government elsewhere in the Member concerned.

51. The European Communities notes that Brazil has not attempted to show that the services offered by EDC are financial contributions in that they involve a cost to the government.

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[9] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" ("United States – FSC"),* WT/DS108/AB/R, adopted 20 March 2000, para.90.

52. On the issue of benefit Brazil has reasoned that if the conditions offered by EDC are more favourable than those allowed by the *OECD Arrangement*, there must be a "*a fortiori*" be a benefit.[10] It also argues that EDC financial services must be a subsidy since EDC states that its financing "complements" what is available on the market. [11]

53. The European Communities would basically agree with the first part of this reasoning without the "*a fortiori*" but disagree with the argument that EDC financial services must be a subsidy since it "complements" what is available on the market. There is no basis for saying that if the government offers something that is not available on the market, it must be offering a subsidy.

54. The European Communities would rather say that if EDC export credits were not available, it must be presumed that official financing would be made available in Canada on *OECD Arrangement* conditions.

55. For the reasons outlined above however, the European Communities does not agree that the existence of a benefit can be established simply from the absence of a "commercial supplier".

56. However, the European Communities would stress that it is not in a position to affirm that EDC does grant export credits for regional aircraft at other than OECD Arrangement conditions. This is a matter to be proved by Brazil.

3.3 "Matching" is covered by the safe haven in the second paragraph of item (k) of the Illustrative List

57. Perhaps the most important issue raised in this case is whether the "matching" provisions of the *OECD Arrangement* are part of the "interest rate provisions" so that matching in conformity with those rules could fall within the safe haven of the second paragraph of item (k).

58. The European Communities is firmly of the view that the "matching" of supported rates, provided for in Article 29 of the *OECD Arrangement* falls within the safe haven of the second paragraph of item (k). Matching is specifically envisaged and authorised by the *OECD Arrangement* but must comply with a strict set of conditions and procedures.

59. Indeed, it makes no sense to consider interest rates in isolation from all the conditions that influence the interest rate. The reference to the "interest rate provisions" of the *OECD Arrangement* must be considered to refer to all the provisions that may affect the interest rate – that is all provisions containing *substantive* rather than *procedural* obligations.

60. The European Communities therefore disagrees with the view taken by the panel in the *Canada – Aircraft* case. It is striking that that panel correctly gave a wide interpretation to the term "export credit practices"[12] which implies that that "interest rate buy downs" (that is interest rate equalisation) were covered by the second paragraph of item (k), but gave an excessively narrow interpretation to the "interest rate provisions" of the *OECD Arrangement*.[13]

61. This excessively narrow interpretation is all the more unconvincing in the light of the correct conclusion that the panel came to later in its report came that:

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[10] First Written Submission of Brazil, para. 53.
[11] First Written Submission of Brazil, para. 60 *et seq.*
[12] In paragraph 5.80 of the Report
[13] *Id.* paragraphs 5.80 – 5.92

> .. 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.[14]

62. 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.[15]

63. 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.[16]

64. 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".

65. 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 should have led it 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."

66. The European Communities considers that the provisions of the *OECD Arrangement* that allow "matching" also serve to "support and reinforce" the other interest rate provisions. It is clear that a deviation from normal *OECD Arrangement* is liable to distort competition. If however, the country that consider initiating such unfair competition knows that other governments will match and give the same conditions then the most important incentive to deviate from the standard disappears. The very existence of a matching possibility is helping to discipline Participants, and if occasionally not enough, at least act as a stop gap measure, until the rules can be clarified by negotiation or via a dispute.

67. The textual basis for the contrary conclusion in the *Canada – Aircraft* panel[17] 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*, 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.

68. 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".[18] That view, however, is

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[14] Paragraph 5.112 *in fine*.
[15] Paragraph 5.114.
[16] Paragraph 7.109.
[17] Paragraphs 5.120 *et seq.*
[18] Panel report, para. 5.125.

not shared by the Participants to the *Arrangement* themselves, who obviously regard matching as being compatible with effective disciplines on export credits.

69. 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.[19]

70. 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 offer or. 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.

3.4 Guarantees are also covered by the *OECD Arrangement*

71. As explained above the European Communities 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.

72. 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.

73. The European Communities would draw the attention of the Panel to the fact that Article 22 of the *OECD Arrangement*, which sets out the disciplines that the are to be respected in calculating risk premia, 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".

4. CONCLUSION

74. The state of the arguments presented by the parties and the information and time for reflection available to the European Communities 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.

[19] Paragraph 5.132.

ANNEX C-2

THIRD-PARTY SUBMISSION OF THE UNITED STATES

(22 June 2001)

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I. INTRODUCTION

1. The United States welcomes this opportunity to present its views in the dispute *Canada – Export Credits and Loan Guarantees for Regional Aircraft* (DS222). The United States will comment briefly on the issues it believes to be of particular importance.

2. Brazil organizes its first written submission as a challenge to the Export Development Corporation (EDC) on the one hand, and the Canada Account on the other. Canada argues in response that the EDC administers two programs, the Canada Account and the Corporate Account, and it addresses Brazil's claims in that manner. The United States leaves it to the Panel to decide how best to characterize the programs at issue. For the sake of convenience, the United States has organized its submission around the underlying substantive issues of the market window, which arises in the context of the Corporate Account; and the status of matching under the *OECD Arrangement*[1], which arises in the context of the Canada Account.[2]

II. FINANCING THROUGH THE "MARKET WINDOW"

3. Brazil claims that Canada provides prohibited export subsidies through its EDC market window operations.[3] Canada's response focuses primarily on its claim that Corporate Account market window financing does not confer a benefit, and thus does not constitute a subsidy at all. The United States takes no position on whether the particular transactions at issue conferred benefits, and thus constituted subsidies. We do, however, wish to make some brief comments on the issue of market windows that we hope will assist the Panel in reaching its own conclusions on this matter.

4. In its written submission, Brazil cites the OECD Trade Directorate's definition of market windows, which is "institutions related to governments which are able to raise finance and lend at very low rates of interest but which may not currently follow all the provisions of the Arrangement."[4] The United States agrees with Brazil that this definition of market windows is accurate. The United States also agrees with Brazil's observation that market windows, through their direct and indirect relationships to governments, are in a position to convey benefits within the meaning of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

5. To elaborate, the competitive pressures on financial actors in the marketplace generate financing offers that reflect any internal cost advantages enjoyed by a particular actor. For wholly commercial actors, however, the ability and willingness to compete is constrained by such factors as balance sheets, true market-determined borrowing costs, arms-length shareholder lending policies, arms-length business costs, and the disciplines imposed by the need to provide returns to owners. Market window operations are largely free of these constraints, and thus are in a position to confer benefits by exceeding, if sometimes only in a small way, what purely market-based financial institutions can (or may be willing to) offer. Their ability to do so explains their existence, since there would otherwise be no reason for market windows to exist in parallel with private financial market actors, much less any logical reason for governments to limit their market window activities to nationals.

6. As Brazil has noted, the confidentiality of market window operations makes it difficult for an outside observer to determine the extent to which a particular market window transaction confers a benefit on a particular recipient. In the U.S. view, however, an appropriate criterion for the Panel to

[1] More specifically, the OECD *Arrangement on Guidelines for Officially Supported Export Credits.*
[2] The United States has no comments on the issue of Investissment Québec Financing.
[3] *See, e.g.*, Brazil's First Written Submission at para. 29.
[4] Brazil's First Written Submission at para. 37.

use in approaching this question would be to compare the terms that a market window offered to a borrower with the terms the borrower would have been able to obtain on the purely commercial market. This is, in fact, the analysis contemplated by Article 14(b) of the SCM Agreement. The Appellate Body has confirmed that Article 14 constitutes relevant context for interpreting the term "benefit."[5]

7. In approaching this issue, however, the Panel should be careful to distinguish between the concepts of "market pricing" and "operating on commercial principles". Canada defends the Corporate Account by claiming that it operates on commercial principles, and thus provides financing at market rates.[6] This statement, in and of itself, is insufficient to demonstrate that EDC's market window support does not confer a benefit. If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that are available in the market. A government entity "operating on commercial principles" is still a government entity. It is not the commercial market.[7]

8. If the Panel were to determine that the financing at issue does confer benefits, and thus constitutes export subsidies, the United States can foresee that the question whether market window financing is eligible for the "safe harbor" in the second paragraph of item (k) of Annex I of the SCM Agreement, the "Illustrative List" of export subsidies, may arise. Briefly, the second paragraph of item (k) is intended to provide a "safe harbor" for financings of a type covered by the *Arrangement*, on terms consistent with the *Arrangement*. This includes financings offered by non-Participants to the *Arrangement* who elect to follow its terms.

9. In the view of the United States, the reference in the second paragraph of item (k) to "an export credit practice which is in conformity with those provisions" encompasses only those export credit practices that are covered by the *Arrangement* (namely, official export credits). Market windows are not presently covered by the *Arrangement*, and therefore it would not be possible for a Member to invoke the item (k) safe harbor to shield export subsidies granted through a market window, even if the terms of the particular market window financing happened to be consistent with the terms of the *Arrangement* that applied to credits offered by official export credit agencies. Applying "*Arrangement* terms" to a type of export credit practice not covered by the *Arrangement* would constitute an "apples and oranges" comparison, since there is no assurance in the abstract that the present *Arrangement* terms would be appropriate for market windows.

III. THE INTERRELATIONSHIP BETWEEN THE "MATCHING PROVISIONS" OF THE *ARRANGEMENT* AND ITEM (K) OF THE ILLUSTRATIVE LIST

10. Brazil argues that Canada provided prohibited export subsidies by using Canada Account financing in support of the Air Wisconsin transaction.[8] Canada appears to concede that it used Canada Account financing in support of that transaction, and it does not contest that Canada Account financing constitutes export subsidies within the meaning of the SCM Agreement. Rather, it defends

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[5] *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, para. 155. Since this information may be difficult to obtain, the Panel might also consider evidence of commercial market practices involving borrowers with financial profiles similar to companies that obtained credits from a market window, or consider other comparisons that would allow an objective determination of this issue.

[6] Canada's First Written Submission at para. 67.

[7] Moreover, while Canada states that EDC prices its market window financing in a way that "reflects" commercial benchmarks and interest rate margins, and that it prices "according to" benchmarks that it derives, this does not necessarily mean the financing is at market rates. *See* Canada's First Written Submission at para. 67.

[8] *See, e.g.*, Brazil's First Written Submission at para. 81.

itself by claiming that the export subsidies at issue fall within the safe harbor of the second paragraph of item (k) of the Illustrative List, because Canada was simply matching an offer made by Brazil.[9] Brazil argues in response that the item (k) safe harbor does not shield otherwise prohibited export subsidies that conform with the matching provisions of the *Arrangement*, citing the finding by the Article 21.5 Panel in *Canada – Aircraft* that the matching provisions are not part of the "interest rates provisions" of the *Arrangement*.[10]

11. The United States takes no position on the merits of the Air Wisconsin transaction. As a general matter, however, the United States agrees with Canada that matching is in conformity with the interest rates provisions of the *Arrangement*, and thus is eligible for the safe harbor in the second paragraph of item (k), regardless of whether the initiating offer is in derogation of *Arrangement* provisions.

12. The *Canada – Aircraft* Article 21.5 Panel stated that the matching of an initiating offer that does not comply with Arrangement terms is itself out of conformity with the interest rate provisions of the Arrangement.[11] In the view of the United States, this formulation is incorrect. For 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 substantive terms and conditions of the *Arrangement.* It would defeat the entire 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.

13. In this sense, the United States disagrees with the *Canada – Aircraft* Article 21.5 Panel's statement that adopting Canada's view "would directly undercut real disciplines on official support for export credits."[12] On the contrary, it is the Panel's interpretation that would undercut *Arrangement* disciplines. The ability of Members to match non-conforming offers creates an incentive for other Members not to make non-conforming offers, lest they find themselves in a subsidy "race to the bottom." Therefore, an interpretation of the second paragraph of item (k) that would prohibit Members who are concerned about respecting their obligations under Article 3 of the SCM Agreement from matching non-conforming offers would remove any such incentive. Conversely, an interpretation of the second paragraph of item (k) that would shield matching offers from the Article 3 prohibition, particularly when the initial non-conforming offers are not themselves shielded, would provide an especially strong incentive against making non-conforming offers in the first instance.

14. Other objections that the *Canada – Aircraft* Article 21.5 Panel raised in response to Canada's interpretation are equally without merit. For example, since the purpose of the matching provision is to dissuade Members from initiating non-conforming offers, adopting Canada's interpretation of the second paragraph of item (k) would decrease the likelihood that the factual scenarios the Panel identified in paragraph 5.137 of its decision would ever arise. Similarly, the Panel's concern (in para. 5.138) that Canada's interpretation would permit Members to "opt out" of their WTO obligations on the basis of the behavior of non-Members is misplaced, because if matching is shielded by the item (k) safe harbor, then a Member who matches a non-conforming offer is acting in accordance with its WTO obligations.

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[9] *See, e.g.*, Canada's First Written Submission at para. 47.

[10] Brazil's First Written Submission at para. 57, *citing 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. 5.125 ("*Canada – Aircraft 21.5"*).

[11] *See Canada – Aircraft 21.5* at paras. 5.125-5.126. Canada did not appeal the findings related to the Canada account, so the Appellate Body did not opine on the Panel's findings.

[12] *See id.* at para. 5.125.

15. Finally, contrary to the Panel's concern (at para. 5.136), Canada's approach to this issue does not raise the issue of structural inequity in respect of developing countries. Article 27 of the SCM Agreement exempts developing countries from the prohibitions of paragraph 1(a) of Article 3, subject to compliance with the provisions in Article 27.4. This exemption applies to all export subsidies, not just to export credits. The exemption in the second paragraph of item (k) is much more limited. Despite its more limited scope, however, the item (k) safe harbor was an important part of the overall package that WTO Members agreed to when they accepted the SCM Agreement.

16. The United States also observes that a non-Participant that seeks protection of the second paragraph 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*.[13] 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 paragraph of item (k).

IV. CONCLUSION

17. The United States thanks the Panel for providing an opportunity to comment on the issues at stake in this proceeding, and hopes that its comments will prove to be useful.

[13] *See, e.g.*, *Arrangement* at arts. 42-53.

ANNEX C-3

ORAL STATEMENT OF THE EUROPEAN COMMUNITIES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

1. The European Communities has already had the opportunity to set out its view on this case in its written submission and will not repeat now what it said there.

2. The European Communities will briefly make some additional comments:

➢Article 10.3 DSU and the perhaps related question of Business confidential information;

➢Comments on Brazil's reply to the preliminary objection of Canada; and

➢Comments on the written observations of the United States.

1. Article 10.3 DSU and Business confidential information

3. The European Communities would first, if you allow, congratulate the Panel on having made the correct response to Canada's request to submit certain crucial information to the Panel only.

4. The DSU provides that panel proceedings are confidential. Panels often have to deal with confidential information. Whether it is described as "government confidential information," "business confidential information", "proprietary information" or "private confidential information" it is all protected by Article 18 of the DSU. After the proceedings are over, there is no problem with a panel omitting certain information from the report that is rendered public.

5. The European Communities considers that it cannot be presumed that Members will not respect the rules of the DSU. It is also firmly of the view that Members may not be prevented from receiving certain information to which they are entitled under the DSU.

6. Therefore the Panel was right to return Canada's information without reading it.

7. The European Communities notes however that Brazil was also asked by the Panel to provide certain information at the same time as Canada. If this information was provided, the European Communities should have received a copy pursuant to Article 10.3 DSU and the European Communities would like to take this opportunity to ask the Panel to clarify this issue.

2. Comments on Brazil's reply to the preliminary objection of Canada

8. The European Communities now understands that Brazil is making three basic "overarching" claims (1, 5 and 7) and that the others are elaborations thereon. The European Communities also notes that it had correctly understood that the claims were all limited to Canadian support to its regional aircraft industry.

9. This said, the European Communities would like to make some comments on the way in which Brazil explains its claims in its reply to the preliminary objection. These comments are inspired by a desire to see the *SCM Agreement* and the DSU correctly applied.

10. The European Communities agrees that it is possible for a Member to attack a subsidy programme "as such" or *per se*. It is also of course possible to attack individual grants under such a programme and even to do both at once. Both programmes and grants are "*measures*" capable of becoming the object of a claim in a request for the establishment of a panel.

11. The arguments that are invoked against each of these measures will not however be the same. To attack a programme, it will be necessary to identify features of the *programme* that are inconsistent with the specified WTO obligations. To attack an individual grant, it will only be necessary to identify features of *that particular grant* that are inconsistent with the specified WTO obligations.

12. It is still not clear to the European Communities which Brazil is seeking to do. The "available evidence" mentioned in Brazil's request for consultations all related to an individual grant –the Air Wisconsin transaction. Brazil now says that it is attacking the programmes "as such" and "as applied". The term "as applied" may mean that Brazil seeks to adduce evidence about the way in which the programmes are applied in order to establish that the programmes are "as such" inconsistent with the *SCM Agreement.* However, Brazil seems to be using the term "as applied" to cover its attack on individual grants.

13. Brazil has invoked certain characteristics of the EDC, Canada account and *Investissement Québec* that it may consider justifies a finding against the *programmes* but it also appears to be arguing that the evidence that it has brought, or is seeking to bring, against *individual grants* of subsidy justify a finding against the programme or alternatively against *all grants* under those programmes benefiting in some way the Canadian regional aircraft industry.

14. The European Communities asks the Panel to carefully distinguish claims against the programmes and claims against individual grants in order to maintain the necessary discipline in dispute settlement and avoid encouraging "fishing expeditions".

3. Comments on the written observations of the United States

15. The European Communities also wishes to comment on the written observations of the United States.

3.1 Matching

16. The European Communities is pleased to note that it is in agreement with the United States on the important issue of matching. The Panel will have noted that the European Communities has made some different arguments in support of the same conclusion. All these arguments reinforce each other and the European Communities hopes that they will allow the Panel to decide that matching in conformity with the *OECD Arrangement* may fall under the safe haven of the second paragraph of item (k) of the Illustrative List.

3.2 Financial contribution and benefit

17. The only other comment that the European Communities would make concerns the United States analysis of "market window" operations as subsidies. The United States reasoning is striking for the complete absence of any consideration of the question of financial contribution. The United States reasoning seems to be that if there is a benefit, there is a subsidy. The EC has already

commented on a similar neglect of the concept of "financial contribution" in Brazil's arguments concerning Article 1.1(a)(1)(iii) *SCM Agreement.* The present comments elaborate on those written comments.

18. The United States goes on to presume that there will always be a benefit whenever a "government entity" does something different from what it calls "the commercial market" it is providing a subsidy. (The European Communities assumes that when the United States uses the term "government entity" it is in fact referring to the notion of "public body" in Article 1.1 *SCM Agreement*. It notes in passing that Canada appears to recognise that EDC is a "public body" in para. 37 of its first written submission.)

19. I will quote the passage with which the European Communities particularly disagrees in paragraph 7 of the United States submission:

> If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that <u>are</u> available in the market. A government entity "operating on commercial principles" is still a government entity. It is not the commercial market.

20. The failure to give proper meaning to the notion of "financial contribution" conflicts with the view of the Appellate Body in *Brazil – Proex* that "financial contribution" and benefit are separate elements. It also largely reduce the notion of "financial contribution" to redundancy, something which we know a treaty interpreter must not do.

21. The United States' reasoning on "benefit" makes any loan (or supply of a service) by a government entity automatically a subsidy if it is providing something that is not available on what the United States calls "the commercial market".

22. As the European Communities stated in connection with its written comments on Article 1.1(a)(1)(iii) of the *SCM Agreement*, in many areas, including export credits and guarantees, governments are often able to offer something that commercial operators do not, or are able to offer it at a better rate, for example, because of some organisational or informational advantage.

23. The European Communities identifies in the United States arguments on this issue, the same omissions that it sees in Brazil's arguments on Article 1.1(a)(1)(iii) of the *SCM Agreement* to which it would again refer the Panel. To summarise, the United States position ignores two fundamental points:

- ➢ Only supplies of loans or services for less than full consideration can be considered to constitute "financial contributions". It is only in such cases that a government can be considered to have "contributed" anything that can be considered "financial".

- ➢ It is too simplistic to consider that a benefit exists whenever a "government entity" supplies something on conditions that are not identical to those of the "commercial market". In some sectors, like for example export credits, government supply of services *is* the market.

24. The European Communities will endeavour to illustrate its point with some examples. If a public body today gives a company $100 in exchange for €100, it will be making a financial contribution. How much will that financial contribution be? I have looked up the answer – it is $14. According to the reasoning that the European Communities is criticising, however, it would be $100, the amount of "transfer of funds". In this example it is also fairly clear that the benefit is the same

amount. If the exchange was $86 for E100, there would today, according to the European Communities, be no financial contribution but still, it seems, a financial contribution according to the approach we are criticising.

25. To take a slightly different example, suppose a public body gives a company $100 in exchange for an amount of non-convertible currency that the government can exchange for the equivalent of $100 but which no private body can. For the European Communities there would be no financial contribution because there is no cost to the government. For others there would still be a financial contribution of $100. The benefit to the recipient is of course likely to be $100.

26. Similarly, if a public body gives 100 US$ to a company in exchange for a promise to repay $110 in a year's time, whether it is making a financial contribution or not will depend on whether, all things considered, there is a cost to the government in doing this. This may well depend on the various means available to the public body (but not necessarily to others) to secure repayment. For the United States and Brazil, it appears, there would always be a financial contribution and the only question would be whether there is a benefit according to some "commercial market".

27. These examples are not academic. The situation concerning export credits and insurance is similar. Public bodies may be in a position to assess the risk of lending to another country and also to secure repayment in case of difficulties that private bodies are not.

28. In a nutshell, whether there is a financial contribution depends on, and is to be assessed from, the perspective of the public body. Whether there is a benefit depends on, and is to be assessed from, the perspective of the recipient. These will not always be the same.

29. The European Communities asks the Panel to take these considerations into account and conduct a thorough analysis of whether there are financial contributions and benefits in order to avoid setting troublesome precedents.

4. Conclusion

30. The European Communities has had very little time to prepare these comments but would reiterate its interest in these proceedings and invite the Panel not to hesitate to ask any questions that it may have. The European Communities will do its best to reply helpfully.

31. The European Communities would like to take this opportunity to thank the Panel for giving it this opportunity to express its views and for listening so attentively.

ANNEX C-4

ORAL STATEMENT OF THE UNITED STATES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

1. Mr. Chairman and Members of the Panel, it is my honour to appear before you today to present the views of the United States as a third party in this proceeding. Instead of repeating the points we made in our written submission, I will limit my comments to responding to certain statements that the European Communities ("EC") made in its 3rd party written submission.

The "Mandatory" vs. "Discretionary" Distinction in Subsidy Cases

2. The first issue I would like to discuss today is the distinction between mandatory and discretionary measures in GATT and WTO jurisprudence. The EC (at para. 34) contests the very existence of the mandatory vs. discretionary distinction, describing it as a "pretended principle." Suffice it to say that the EC's view is not shared by the many WTO panels that have considered the issue, including the recent *Hot-Rolled Steel* panel which described the principle (at para. 7.141) as "well established", or by the WTO Appellate Body, which recognized the distinction and discussed it at length in *United States – 1916 Act.* The principle was also at issue in the ongoing case of *Export Restraints*. Although that report has not yet been circulated to the WTO Membership, we assume that it may contain insights that the Panel will find useful.

3. The EC is similarly misguided when it describes Article XVI:4 of the *Marrakesh Agreement Establishing the World Trade Organization* as a new, "fundamental" principle that requires Members to "ensure that their laws do not specifically allow or envisage WTO inconsistent action." This assertion, aside from requiring dramatic, wholesale changes to Members' laws, is simply wrong. Parties to an international agreement have, by becoming parties, committed to implement their agreement obligations in good faith. Accordingly, one cannot assume that authorities will act in bad faith by exercising their discretion under domestic legislation so as to violate international obligations, and the WTO Agreements provide no basis for requiring Members to craft their laws in a way that would remove all such discretion.

4. The United States has addressed the mandatory vs. discretionary distinction on numerous occasions, in numerous disputes. Instead of repeating those discussions here, I would simply invite the Panel to review our submissions on this topic, in particular in the *Export Restraints* dispute, all of which are public (see http://www.ustr.gov/enforcement/briefs.shtml).

Proper Interpretation of Article 1.1(a)(1)

5. I will now turn to the proper interpretation of Article 1.1(a)(1) of the *Agreement on Subsidies and Countervailing Measures*. In challenging Brazil's argument that EDC activities can be considered export subsidies, the EC claims (from para. 42) that Article 1.1(a)(1)(iii) of the SCM Agreement only applies to "supplies of services for less than full consideration. " Stated differently (*e.g.*, at para. 47), the EC believes that there must be a "cost to the government" for there to be a financial contribution under Article 1.1(a)(1)(iii). It is important to note, moreover, that the logic of its argument would pertain to all parts of Article 1.1(a)(1). The plain language of the SCM Agreement provides no support for the EC's position. (See also the discussion of a similar issue in the original proceedings in the *Canada - Measures Affecting the Export of Civilian Aircraft* dispute,

WT/DS70, for example at para. 9.118 of the Panel report and paras. 154-156 of the Appellate Body report.)

6. As Article 1.1(a)(1) makes clear, the term "financial contribution" does not apply only when there is a cost to the government. For example, Article 1.1(a)(1)(i) of the SCM Agreement includes loans among the types of government practices that constitute financial contributions. The language is unambiguous: *if* there is a loan, *then* there is a financial contribution. A loan that costs the government nothing is still a loan, and thus is a financial contribution under Article 1.1(a)(1). The cost to government concept has no relevance to this issue.

7. In addition to contradicting the plain language of Article 1.1(a)(1), the EC's approach suffers from another infirmity. Under the plain language of Article 1.1(a)(1)(iv), there *is* a financial contribution when a government entrusts or directs a private body to carry out one of the functions illustrated in subsections (i) through (iii). However, there would be no cost to the government in such a situation. By reading subsection (iv) out of Article 1, the EC's interpretation violates the principle of the effectiveness of treaty interpretation.

8. The EC claims (at para. 47) that including the cost-to-government concept in the definition of financial contribution is necessary to ensure that the SCM Agreement does not treat "all" government services as subsidies, such as when a government is able to offer "something that commercial operators do not, or are able to offer it at a better rate." But the SCM Agreement already contains ample limitations on what constitutes a subsidy that falls within the bounds of the Agreement without grafting on the EC's additional, unmerited, requirement. Namely:

- There must be a financial contribution within the meaning of Article 1.1(a)(1);
- which confers a benefit within the meaning of Article 1.1(b);
- and is specific within the meaning of Article 1.2.

9. In addition, even if there is a subsidy under these criteria, it would be prohibited or actionable only if it was an export subsidy, an import substitution subsidy, or causing adverse effects within the meaning of Part III of the SCM Agreement. Therefore, the EC's fears are groundless.

"Matching" and the Second Paragraph of Item (k) of the Illustrative List

10. The second from final issue I would like to address is the EC's comments about the interrelationship between item (k) of the SCM Agreement's Illustrative List and the matching provisions of the *OECD Arrangement*. Unlike with respect to the EC's claims about the mandatory/discretionary distinction and the cost to government concept, the United States is in general agreement with the EC's statements (from para. 57) on the issue of matching and item (k). In particular, although we did not address the issue in our written submission, we agree with the EC (at paras. 71-73) that guarantees are covered by the *OECD Arrangement*.

11. The United States would like to address one more point in response to the EC's oral statement today, and that is concerning business confidential information. The United States position on this is well known - we believe that there may be situations in which it is necessary to have additional procedures in place to protect business confidential information. Article 18 of the DSU is not always a sufficient safeguard. For example, we would note that just recently an interim panel report, which is confidential under the terms of Article 18 of the DSU, was published immediately after it was provided to the parties.

12. This concludes my presentation. Thank you again for this opportunity to express our views.