6

Canada – Export Credits and Loan Guarantees for Regional Aircraft (WT/DS222/R) A Comment

BY

ROBERT HOWSE

(University of Michigan Law School)

AND

DAMIEN J. NEVEN

(Graduate Institute of International Studies, Geneva and CEPR)

1 Introduction

This panel report represents another installment in the long-standing litigation between Canada and Brazil over subsidization of sales of commuter jets by both countries. The report addresses a set of claims by Brazil closely related to prior claims concerning the practices of the Export Development Corporation as well as industrial policy entities in the Canadian province of Quebec. Brazil specifically challenged certain recent transactions where these federal and provincial entities provided certain kinds of financing assistance in connection with the sale of Bombardier aircraft (namely to Air Wisconsin, Atlantic Coast Airlines, Comair, Kendell, and Air Nostrum). For the most part the panel applied existing jurisprudence on export subsidies to the factual record. In particular, the panel applied a "private investor principle", verifying in all instances whether the conditions that were granted by the export development and industrial policy agencies were more favorable than the conditions that were available from alternative private sources. However, it is

extremely difficult to provide an adequate commentary on the panel's comparison between the conditions available in the market and those granted by the agencies because vital factual information concerning the transactions in question has been removed from the panel report for reasons of commercial confidentiality.

Thus, in our Report, we focus on several specific areas, largely of a procedural and preliminary nature, where the panel made apparently novel findings of law that have some systemic or general significance for WTO jurisprudence and practice.

Some preliminary comments on the general approach of the panel may however be in order. It is striking that the panel paid a lot of attention to the distinction between programs that leave some discretion to the authorities granting subsidies which may be unlawful and programs which instruct the authorities to do so. According to the panel, only programs which instruct the authorities to grant unlawful export subsidies are as such unlawful, despite the fact that the declared objective of these programs is to grant export subsidies (which are likely to be unlawful). Hence, everything appears as if the programs are not unlawful because one can exclude that they may not pursue the objective that has been assigned to them.

The apparent contradiction between the objectives assigned to the agencies and the behavior that they are meant to pursue in order to comply with the WTO framework is reinforced by the application of the private investor principle. According to this benchmark, particular loans and guarantees are lawful if they could have been obtained from private investors. Here again, the behavior of the agency is lawful where it mimics the behavior of private sources of funds – which suggests that they should not have been public agencies in the first place or at the very least that their public status (and the particular objectives that they are supposed to pursue in light of this status) should be seen as irrelevant.

Overall, one can thus wonder about the effectiveness of a legal framework that imposes behavioral norms on an institution that are in contradiction with its "raison d'être".

This raises the broader question of whether the constraints imposed by the SCM agreement are reasonable. A discussion of this issue goes much beyond the scope of this chapter. It is worth mentioning however that subsidies can sometimes be highly desirable (see Besley and Seabright, 2000, for a discussion) and that the blanket prohibition on export subsidies contained in the SCM agreement may not be warranted.

2 Jurisdiction of 21.5 Panels in Relation to Panels Seized of a New Matter

In its Request for a Panel Brazil included claims related to the alleged non-compliance of Canada with previous panel rulings. This was particularly evident with Claim 3, which alleged: "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 . . ."

Article 21.5 of the DSU provides: "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." Canada argued that, to the extent that Brazil was making a claim concerning "existence or consistency" of measures taken to implement a pre-existing DSB ruling, it was required to make that claim under 21.5, and thus that the present panel did not have jurisdiction to adjudicate.

The panel responded in several different ways to this argument of Canada. First of all, the panel observed that Brazil was not, strictly speaking, asking it to examine the measures in question to determine their consistency with a prior ruling of the DSB, but rather to determine their consistency with provisions of the WTO SCM Agreement. In other words, even though Brazil was asserting the inconsistency of Canada's measures with earlier rulings, it was asking the panel for de novo review of those measures, not findings concerning their consistency with the earlier rulings.

The problem with the distinction the panel draws here, upon Brazil's suggestion, is that, according the Appellate Body, it is *precisely* the role of a 21.5 panel to examine, in respect of measures that were the subject of previous panel rulings, whether the subsequent conduct of the defendant relating to those measures is consistent with the provisions of covered Agreements (*Shrimp/Turtle 21.5*, para. 85, *Brazil – Aircraft 21.5*, para. 35.).

The logic of the panel here would seem to have the following result: where a previous panel found a measure inconsistent with certain provisions of the covered Agreements, and the defendant changed the measure such that it now fell afoul of different provisions, not dealt with in the original panel report, this would not be a matter for a 21.5 panel, but an entirely new panel, based on new terms of reference.

If this were so, then a defendant could avoid the expedited procedures under 21.5 simply by redesigning its measure so as to make it inconsistent

with different provisions of the covered Agreements than those dealt with in the original panel proceeding. It may be in part for this reason that, repeatedly, the Appellate Body has made it clear that the 21.5 panel can and must consider the consistency of any new or modified measure with the covered Agreements, not just with the previous rulings and recommendations of the panel.

Secondly, the panel noted that Brazil said it was simply seeking a factual finding that since the adoption of the prior 21.5 report Canada had not made any changes in one of the measures in question, the so-called Canada Account. The panel relied on Article 11 of the DSU to simply refuse to consider this question of fact on the grounds that it would not assist in the panel's determination of Brazil's claims of violation of the SCM agreement in the present proceeding.

This reasoning of the panel is rather hard to follow. Given that the 21.5 panel had found the Canada Account in violation of the prohibition of export subsidies in the SCM agreement, a factual finding that the measure was unchanged since that previous ruling would seem to have cardinal importance for resolving Brazil's *new* claim of violation in respect of the same measure. It would mean that *res judicata* would arguably apply, since the new claim of violation concerns a measure found, as a matter of fact, to be identical to one previously ruled in violation.[1]

Where a measure is identical to one that has already been adjudicated and is the subject of an adopted DSB ruling, it does not seem appropriate for a later panel to assess *de novo* whether that measure is consistent with the very same provisions that were the subject of the previous

[1] See the *India – Autos* panel, where the first step in the analysis in determining whether there could be *res judicata* was to consider whether certain legal claims *and* measures already adjudicated were *identical* to those now before the panel. (paras. 7.83–7.103). The *India – Autos* panel never reached the issue of whether *res judicata* actually applies in WTO proceedings but began with investigating whether, *assuming res judicata* did apply, the criteria of identity of claims and measures could be met in this particular case. Having determined that they could not, the panel considered it unnecessary to provide a definitive answer to the question of whether *res judicata* is available in WTO law. In the *Argentina – Poultry* case the panel rejected an argument that *res judicata* applied with respect to previous proceedings in a *non*-WTO forum, MERCOSUR, but it also seemed to question whether *res judicata* could exist even as between an earlier and later WTO proceeding. In *Argentina – Poultry*, the panel seemed to confuse the issue of whether the *res judicata* could apply in later proceedings between the same parties on the same matter, with the question of whether panel rulings have binding precedential authority, i.e. are *stare decisis* in different matters between different parties (which of course they are not).

adopted ruling. This would be inconsistent surely with the principle of finality of adopted DSB rulings, as between the parties. Thus, it was arguably important, assuming that it was correctly seized at all with the issue, for the panel to determine whether the Canada Fund was unchanged, in order to be able to decide whether the matter was indeed *res judicata*.

Thirdly, the panel, in attempting to distinguish the kind of claim Brazil was making from a 21.5 claim, noted that "Brazil's claims in this proceeding do not concern the specific financing transactions "at issue" in the [earlier] *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" (Paragraph 7.18).

But the Appellate Body has made it clear that it is precisely the mandate of a *21.5* panel to consider the measure as modified and applied *subsequent* to the original panel ruling (*Shrimp/Turtle 21.5*). This will normally and naturally involve new transactions, to the extent that the application of the measure is at issue. So why the existence of different transactions or changes in legal framework would take the claims of Brazil out of the jurisdiction of a 21.5 panel or make it appropriate for a new panel instead to seize itself of the matter is entirely obscure.

One could regard the panel's findings on the issue of the relationship of its jurisdiction to that of a 21.5 panel in two different ways. The panel might have been saying that there is some overlap between 21.5 jurisdiction and the jurisdiction of an entirely new panel in cases where the new complaint concerns both measures that were already adjudicated by a prior panel and some measures that have not been the subject of the prior adjudication. Or alternatively it could be taken as saying that certain defined features of Brazil's claim in this case would make 21.5 jurisdiction inapplicable (new transactions, changes in legal framework). If it is the latter, the panel's ruling seems clearly inconsistent with the view of the AB on the appropriate scope of a 21.5 panel's inquiry.

On the former interpretation, the main systemic issue that arises is one of forum shopping. This is especially so given the apparent avoidance of the panel of *res judicata*, with the implication that it can review *de novo* on-going conduct that was the subject, in part, of a previous panel ruling. If a complainant did not find the ruling of a panel sufficiently favorable, including a 21.5 panel, it could start a new proceeding and have a different panel examine the same on-going conduct. While the new panel could presumably only address those aspects of the on-going violation that are subsequent to the first panel's ruling, nevertheless the complainant might

now achieve legal and factual rulings that lead to a recommendation that the on-going measure be removed, thus achieving a prospective remedy, which is really the only kind (generally speaking) the WTO dispute settlement system can offer. Such forum shopping seems at odds with a number of principles stated in the DSU, including the notion of prompt settlement (3.3). One curb on such forum shopping may arise from the ruling of the AB in *Shrimp/Turtle 21.5* that where an adopted Appellate Body report has found a measure or an aspect of a measure to be **not** in violation, it is appropriate for the 21.5 panel not to re-examine the issue, but to rely on the earlier finding of non-violation. Thus, in the *Shrimp/Turtle 21.5* appeal, Malaysia sought to re-open the issue of whether the United States measure, as opposed to its application, violated provisions of the covered agreements.

The AB had previously found that the measure itself was consistent with the GATT obligations of the United States and it noted in the 21.5 appeal:

> As we see it, then, the Panel properly examined Section 609 as part of its examination of the totality of the new measure, correctly found that Section 609 had not been changed since the original proceedings, and rightly concluded that our ruling in *United States – Shrimp* with respect to the consistency of Section 609, therefore, still stands. We wish to recall that panel proceedings under Article 21.5 of the DSU are, as the title of Article 21 states, part of the process of the "*Surveillance of Implementation of Recommendations and Rulings*" of the DSB. This includes Appellate Body Reports. To be sure, the right of WTO Members to have recourse to the DSU, including under Article 21.5, must be respected. Even so, it must also be kept in mind that Article 17.14 of the DSU provides not only that Reports of the Appellate Body "shall be" adopted by the DSB, by consensus, but also that such Reports "shall be . . . unconditionally accepted by the parties to the dispute. . . ." Thus, Appellate Body Reports that are adopted by the DSB are, as Article 17.14 provides, ". . . unconditionally accepted by the parties to the dispute", and, therefore, must be treated by the parties to a particular dispute as a final resolution to that dispute. In this regard, we recall, too, that Article 3.3 of the DSU states that the "prompt settlement" of disputes is essential to the effective functioning of the WTO.
>
> (paragraphs 97–98)

Assuming this reasoning were also to apply to adopted panel reports, a complaining Member would effectively be prevented from going to a new panel in order to seek a ruling of violation that it was not able to get from an earlier panel or AB decision, at least in respect of the same on-going measure.

3 The Mandatory/Discretionary Distinction and Brazil's Claims

Brazil argued that the Canadian legal framework for export financing itself violated the prohibition on export subsidies in the SCM Agreement, inasmuch as that framework at least implicitly contained a *mandate* to responsible officials to engage in export subsidization. In addition, Brazil argued that the way the framework was applied was itself a violation of the SCM Agreement. Finally, Brazil challenged the practices and policies adopted with respect to a set of specific transactions.

The panel took a very formalistic view of whether the Canadian legal framework mandated export subsidization, looking only at the face of the Canadian law, which, not surprisingly, did not contain any explicit instruction to officials that they must provide export subsidies of a kind prohibited by the SCM Agreement. The panel choose to ignore, or consider irrelevant to the issue of mandatory legislation, the various arguments of Brazil that the legal framework had to be read in light of the policy context, and the inherent nature of the activities that the export financing entities were funded to engage in. In effect, Brazil was saying that when one examined the overall nature of the Canadian government's commitment to export promotion, the mandate of for example the EDC went along with very serious "cues" that it would be expected to confer a non-market competitive advantage on Canadian exports.

Whether or not Brazil could make that case persuasively, the panel's exclusive emphasis on the form or face of the legal framework in assessing whether it mandated a violation of the SCM Agreement is not consistent with the more contextual approach of panels in other situations where they have looked at whether there was a mandatory or regulative government action in a particular situation, for example the *Semi-Conductor* and *Kodak-Fuji* cases. A legislative framework may mandate a WTO violation, we would argue, even if none is required by its facial provisions, if the legislative framework creates strong disincentives or incentives on officials or other actors to engage in behavior violating WTO rules. At one level, the panel may be right that Brazil on the facts did not bear the burden of proof in showing this to be the case. But at numerous points in its ruling, the panel appears to be going further, suggesting that the case must be made exclusively on the basis of the formal juridical character of the Canadian law.

This may have been an instance where Brazil would have been better off not admitting as apparently it did that the distinction between mandatory and discretionary legislation should be dispositive of its claim against the

Canadian legal framework "as such". That is, Brazil might well have argued that the appropriate approach to state responsibility in a case like this, which relates to intense competition in a single product market, would be to employ the kind of test utilized by the panel in the *S. 301* case, namely whether the kind of legal insecurity with respect to WTO rights created by the legislation is such as to give rise, in the context, to state responsibility based on the legal framework alone. Certainly, Brazil would have had a plausible case that the signals sent by the kind of programs established by Canada as such were sufficiently strong as to induce in Canada's Brazilian competitor a strong sense that it could not rely simply on market competitiveness to survive in the marketplace, due to the likely intervention of Canadian authorities to provide financing that would make the competing Canadian product more attractive to buyers, all other things being equal. This sense of insecurity would induce Embraer itself to invest resources in obtaining assistance from its own government, especially given that Embraer could not know exactly what Canada might, or might not, be offering to a given purchaser. In other words, the legal insecurity created by Canada's programs as such (and reinforced by Brazil's experience with their application to *past* transactions) would undermine one of the basic purposes of the SCM Agreement and binding dispute settlement in subsidies cases – to provide a viable response to a party concerned about the export subsidy practices of another party, which avoids the concerned party protecting the interests of its producers by resorting to competitive subsidization or attempted "matching".

Brazil may have had a good argument that when one looked to the Canadian legal framework, especially "as applied", one could discern patterned, norm-based conduct that attracts state responsibility, even apart from individual discrete discretionary decisions on particular transactions.

Because Brazil did not make this argument through the conceptual optic in the *301* case, it was largely lost on the panel, especially what it would mean to find a violation in the legal *scheme* "as applied" as opposed to or distinct from violations arising from individual acts of discretion in respect of particular transactions.

To recall *301,* there the panel found that, although the scheme on its face gave rise to legal insecurity of a kind such as, in the circumstances, to attract state responsibility, the broader legal context was such as to remove this insecurity, i.e. to give sufficient confidence that the scheme would not be interpreted and applied as if it mandated a violation

of WTO rules. Here, Brazil was making an argument that was sort of a mirror image of that analysis – even if the formal elements of the Canadian legal framework did not, on their own, create the kind of legal insecurity that implicates state responsibility, when one considered the *pattern* of application or interpretation of the export financing entities' mandates, these schemes themselves did function such as to create the relevant level of legal insecurity, thus justifying a finding of violation, independent of the discretionary decisions of officials on particular transactions.

4 The Relationship of the SCM Agreement to the OECD Arrangement

The Panel revisited this issue, which has been addressed in earlier panel reports and Appellate Body rulings in the *Canada – Brazil* aircraft dispute.

Canada argued that its subsidies fell within the "safe harbor" of Annex I paragraph (k) in the SCM Agreement, which provides that export credit practices "in conformity with" the interest rate provisions "an international undertaking on official export credits to which at least twelve original Members of this Agreement are parties as of 1 January 1979", i.e. the *OECD Arrangement* by any other name. According to Canada the *OECD Arrangement* permitted matching of concessional interest rates, either those offered by a competing country on the basis of provisions of the *OECD Arrangement*, or as was relevant here, in derogation from the *Arrangement*.

While not definitively concluding that the *OECD Arrangement*, taken on its own, prohibits "matching" of derogations, the panel concluded that it would be inappropriate to incorporate into WTO law such an expansive understanding of the *OECD Arrangement*.

The panel suggested that the matching of a derogation would itself be a derogation and therefore not "in conformity with" the *OECD Arrangement*, unless it were understood as a permitted form of self-help. While the notion of self-help might be consistent with the nature of the OECD Arrangement as a "gentleman's agreement", it was not consistent with the WTO system, which prohibits self-help (7.170).

This is clearly erroneous. If the WTO system prohibited self-help, then it would prohibit countervailing duty actions against prohibited subsidies.

The panel also suggested that if the *OECD Arrangement* were incorporated into the SCM Agreement such as to permit matching of derogations

of participants, non-participants in the OECD Arrangement would be at a disadvantage, as they would lack knowledge of such derogations, and thereby the opportunity for matching them. On the other hand, where what was being matched was an interest rate permitted under an explicit exception in the *OECD Arrangement*, the non-participants would be able to know what they needed to match, since the explicit exceptions are in a public document, the *Arrangement* itself. As Canada attempted to explain to the panel, this distinction is largely false, because the public document contains only notice of the theoretical possibility of concessional financing being offered on the basis of the exceptions in question, but does not provide information about what might actually be offered in any given transaction, i.e. the information needed for effective "matching".

In addition, the panel expressed the concern (7.177) that if "matching" of derogations were permitted, and a derogation were taken by a non-WTO Member, the benchmark for whether a export subsidy was permitted or not under the WTO rules would be the conduct of that non-Member. The panel found it unacceptable that the limits of WTO rights could be determined by non-Members. Nevertheless, the latest version of the *OECD Arrangement* does not list any non-WTO Members as participants, so this concern appears to be entirely hypothetical (in theory, non-WTO Members could be invited to join the arrangement, however unlikely this is in the current situation). Moreover, where an export subsidy is "matching" the subsidy of a non-WTO Member, it is difficult to see an issue arising under the SCM Agreement in the first place, since the non-WTO Member would not have any standing to challenge the "matching" subsidy. Assume for the sake of argument that Brazil is not a Member of the WTO – Canada matches Brazil's alleged derogation from the *OECD Arrangement*, but since Brazil has no rights under the SCM Agreement, nor Canada any obligations towards Brazil, it is not really the case that the limits of WTO rights and obligations are being determined by the conduct of a non-Member.

Of course, Brazil and Canada could be competing hypothetically with a third country, a WTO Member (let's say South Africa) for commuter jet sales. Canada legally matches Brazil's derogation, and so arguably this limits in effect its obligation to South Africa under the SCM Agreement. But doesn't the same problem arise with respect to matching of an interest rate explicitly permitted under an exception in the *OECD Arrangement*, namely, the conduct of a non-WTO Member, Brazil, triggers a legal right to match, which limits the rights of South Africa, a WTO Member, under the SCM Agreement?

Now it is true that because the exception is explicitly detailed and circumscribed in the OECD Arrangement, there is a fixed outward limit, as it were, on how much South Africa's rights could ultimately be limited by Brazil's conduct, which doesn't so obviously exist in the case where it is derogations that are matched. This fixed outward limit is itself however determined in a body participation in which does not have WTO Membership as a prerequisite.