WTO DISPUTE ANALYSIS*

Centre for WTO Studies
Indian Institute of Foreign Trade
New Delhi

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Reports of the Panels

CANADA – CERTAIN MEASURES AFFECTING THE RENEWABLE ENERGY GENERATION SECTOR

CANADA – MEASURES RELATING TO THE FEED-IN-TARIFF PROGRAM

(WT/DS412/R; WT/DS426/R)
(Circulated on 19 DECEMBER 2012)[1]

Parties:

Complainants:	Japan (WT/DS412), European Union (EU) (WT/DS426)
Respondent:	Canada
Third Parties:	Australia, Brazil, China, El Salvador, EU (only in WT/DS412), Honduras (only in WT/DS412), India, Korea, Mexico, Norway, Kingdom of Saudi Arabia, Chinese Taipei, Japan (in WT/DS426), Turkey (only in WT/DS426), United Sates.

Panellists:

Thomas Cottier (Chairperson), Alexander Erwin (Member), Daniel Moulis (Member)

I. BACKGROUND

These disputes concern certain measures relating to domestic content requirements attached to the FIT and microFIT contracts, granted under the feed-in tariff programme (the "FIT Programme") for certain wind and solar photovoltaic ("PV") electricity generation projects established by the Canadian Province of Ontario. The complainants challenged, *inter alia*, the WTO consistency of the following measures:

(i) the Electricity Act of 1998;
(ii) the Green Energy and Green Economy Act of 2009;
(iii) the Electricity Restructuring Act of 2004;
(iv) the Ontario Regulation 578/05;
(v) the Independent Electricity System Operator (the "IESO") Market Manual;

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**This issue can also be accessed online at http://wtocentre.iift.ac.in/DisputeAnalysis.asp . Queries and comments are most welcome and may be directed to disputes_cws@iift.ac.in.

[1] The Panels issued these Reports in the form of a single document constituting two separate Panel reports WT/DS412/R and WT/DS426/R.

(vi) the IESO Market Rules;
(vii) the FIT direction dated 24 September 2009 from the Deputy Premier and Minister of Energy and Infrastructure;
(viii) individual FIT and microFIT Contracts executed by the Ontario Power Authority (the "OPA");
(ix) the FIT Rules and microFIT Rules issued by the OPA;
(x) the FIT and microFIT Contracts issued by the OPA;
(xi) the FIT Application Form and the online microFIT Application issued by the OPA;
(xii) the FIT and microFIT Price Schedules issued by the OPA;
(xiii) the FIT Programme Interpretations of the Domestic Content Requirements; and
(xiv) any amendments or extensions of the foregoing, any replacement, renewal, implementing or related measures.

Consultations were held between Japan and Canada on 25 October 2010, and between the EU and Canada on 7 September 2011. These consultations failed to resolve the disputes. Thereafter, the complainants separately requested the establishment of a panel pursuant to Articles 4.7 and 6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU"), Article XXIII of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), Article 8 of the Agreement on Trade-Related Investment Measures (the "TRIMs Agreement"), and Articles 4.4 and 30 of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement"). At its meetings on 20 July 2011 and 20 January 2012, the Dispute Settlement Body (the "DSB") established the two Panels. (Paras 1.1 to 1.10)

Enhanced Third Party Rights
At Canada's request, and as accepted by Japan and the EU, enhanced third-party rights were granted to all third parties. Third parties in both disputes had the right to: (i) attend the entirety of all substantive meetings between the parties and the Panel; and (ii) receive copies of the parties' written submissions made in advance of the issuance of the interim report to the parties, including first written submissions, written rebuttals, and responses to questions from the Panel at the time that they were submitted to the Panel. (Para 1.11)

Amicus Curiae Briefs
The Panel had also received two unsolicited amicus curiae briefs relating to the disputes. Subsequently, and consistent with the approach taken by previous panels, the Panel informed the parties that it would take the briefs into account only to the extent the parties decided to incorporate them into their own submissions. Taking into account the parties' view, the Panel did not find it necessary to take the briefs into account in its analysis of the claims and arguments made in these disputes. (Para 1.13)

II. KEY ISSUES AND PANEL FINDINGS

A. Whether Canada acted inconsistently with Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994

1. Whether the measures at issue were trade-related investment measures

The Panel noted that although Article 1 of the TRIMs Agreement stipulated that it applied to investment measures related to trade in goods only, it did not define *trade-related investment measures* ("TRIMs"). The complainants argued that the measures at issue were TRIMs because they encouraged investment in the local production of renewable energy generation equipment and components in Ontario; and affected trade in wind and solar energy generation equipment by favouring Ontario products over imported products. (Para 7.108)

With respect to whether the challenged measures constituted "*investment*" measures, the Panel noted that the evidence before it revealed that, as argued by the complainants, one of the aims of the FIT Programme, and the FIT and microFIT Contracts, was to encourage investment in the local production of equipment associated with renewable energy generation in the Province of Ontario.

As to whether the measures were "*trade-related*", the Panel noted that the FIT Programme imposed a "Minimum Required Domestic Content Level" on electricity generators utilising solar PV and wind power technologies that compelled them to purchase and use certain types of renewable energy generation equipment sourced in Ontario in the design and construction of their facilities. To this extent, the Panel saw the "Minimum Required Domestic Content Level" that was at issue in these disputes to be not unlike the domestic content requirements challenged in *Indonesia – Autos*[2], where the panel had opined that by definition, domestic content requirements always favoured the use of domestic products over imported products, and therefore affected trade. (Paras 7.108-7.111)

Thus, based on the foregoing analysis, the Panel found that the FIT Programme, and the FIT and microFIT Contracts, to the extent they envisaged and imposed a "Minimum Required Domestic Content Level", constituted TRIMs within the meaning of Article 1 of the TRIMs Agreement. (Para 7.112)

2. Whether the measures at issue were inconsistent with Article 2.1 of the TRIMs Agreement because they were allegedly inconsistent with Article III:4 of the GATT 1994

   (i) Whether the challenged measures were outside the scope of Article III:4 of the GATT 1994 by virtue of the operation of Article III:8(a) of the GATT 1994

Whether Paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement precluded the application of Article III:8(a) of the GATT 1994 to the challenged measures

(***Key Question:*** *Where a particular TRIM involves the same kind of government procurement transactions as described in Article III:8(a), can it be found to be inconsistent with the obligations in Article 2.1 of the TRIMs Agreement?*)

Article 2.1 of the TRIMs Agreement states:

> "Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994."

The Panel stated that it was important to note that the "provisions of Article III" that were referred to in Article 2.1 of the TRIMs Agreement included Article III:8(a). This provision precluded the application of the obligations set out in Article III to "laws, regulations or requirements governing" certain types of government procurement. Consequently, any government procurement transactions covered by the terms of Article III:8(a) of the GATT 1994 would be removed from the scope of the obligations set out in Article III, including Article III:4. Thus, according to the Panel, where a particular TRIM involved the same kind of government procurement transactions described in Article III:8(a), it could not be found to be inconsistent with the obligation in Article 2.1 of the TRIMs Agreement. The Panel further elaborated and said:

> "Article 2.2 of the TRIMs Agreement does not impose any obligations on Members, but rather informs the interpretation of the prohibition set out in Article 2.1. In particular, Article 2.2 explains that the

[2] WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R

> TRIMs described in the Illustrative List of the Annex to the TRIMs Agreement are to be considered inconsistent with Members' specific obligations under Articles III:4 and XI:1 of the GATT 1994. It does not follow, however, that TRIMs having the same characteristics as those described in Paragraph 1(a) of the Illustrative List must be automatically found to be inconsistent with Article III:4 of the GATT 1994 *when they would otherwise be covered by the terms of Article III:8(a) of the GATT 1994*. Such a reading of Article 2.2 would be inconsistent with the clear terms of Article 2.1, which explicitly state that there will be a violation of Article 2.1 of the TRIMs Agreement whenever a measure is inconsistent with Article III of the GATT 1994. This refers to *the whole of Article III, including Article III:8(a)*." (Para 7.119)

Thereafter, the Panel also specified the order of the analysis and stated that where in a particular case it was found that the national treatment obligation in Article III:4 applied to a challenged measure, the Illustrative List may be used to determine whether the challenged measure was inconsistent with that obligation through the operation of Article 2.1 of the TRIMs Agreement. Where such a measure had the characteristics that were described in Paragraph 1(a) of the Illustrative List, it followed from the clear language of the provision that it would be in violation of Article III:4 of the GATT 1994, and thereby also Article 2.1 of the TRIMs Agreement. Given the language of Article 2.1, it would, in the Panel's view, be inappropriate to infer from Paragraph 1(a) of the Illustrative List that TRIMs having the characteristics described in that paragraph will *always* be inconsistent with Article III:4 of the GATT 1994, irrespective of whether they may be covered by the terms of Article III:8(a) of the GATT 1994. (Para 7.120)

In the light of the above, the Panel concluded that Paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement did not obviate the need for it to undertake an analysis of whether the challenged measures were outside of the scope of application of Article III:4 of the GATT 1994 by virtue of the operation of Article III:8(a) of the GATT 1994. (Para 7.121)

Whether the challenged measures were of the kind described in Article III:8(a) of the GATT 1994

The Panel noted that these proceedings were the first where a panel had been asked to interpret and apply Article III:8(a) of the GATT 1994. It stated that the parties' arguments appeared to raise issues with respect to the following three questions and it addressed the same accordingly:

a. whether the challenged measures could be characterized as "laws, regulations or requirements *governing* procurement"

According to the Panel, the "Minimum Required Domestic Content Level" was a necessary prerequisite for the alleged procurement by the Government of Ontario to take place, and to this extent, it was of the view that such requirements "govern(ed)" the alleged procurement. Furthermore, it observed that the electricity allegedly procured by the Government of Ontario under the FIT Programme was produced using the renewable energy generation equipment that was the subject of the "Minimum Required Domestic Content Level". Thus, to the extent that the "Minimum Required Domestic Content Level" related to the very same equipment that was needed and used to produce the electricity that was allegedly procured, there was very clearly a close relationship between the products that were affected by the relevant "laws, regulations or requirements" (renewable energy generation equipment) and the product that was allegedly procured (electricity). Thus, it found that the "Minimum Required Domestic Content Level" should be properly characterized as one of the "requirements governing" the alleged procurement of electricity for the purpose of Article III:8(a) (Para 7.127)

b. whether the challenged measures involved "procurement by governmental agencies"

The Panel then proceeded to examine whether the measures at issue involved "*procurement* by

governmental agencies of products *purchased*" within the meaning of Article III:8(a) of the GATT 1994. The EU and Canada considered that the ordinary meanings of the words "procurement" and "purchased" should be understood, in the context of Article III:8(a) of the GATT 1994, to imply the same governmental action of *acquiring* a product. Japan, on the other hand, submitted that the notion of "procurement" referred to in Article III.8(a) was not entirely captured by the meaning of "purchased" that was advanced by the EU and Canada and finding that "procurement by governmental agencies" existed, involved consideration of four factors, which included governmental use, consumption or benefit. (Para 7.130)

(***Key Question:*** *Does the term 'procurement' used in Article III:8(a) of GATT 1994 necessarily include governmental use, consumption or benefit?*)

The Panel differed from Japan and stated that the notion of governmental *use, benefit or consumption* was not immediately apparent from the ordinary meanings of these terms. According to the Panel, the fact that Article III:8(a) described the "*procurement* … of products" as "products *purchased*" would seem to confirm the view that the term "procurement" in Article III:8(a) should be given the same essential meaning as the word "purchased" and *vice versa*. Moreover, it felt if the notion of "procurement" that was referred to in Article III:8(a) were interpreted to necessarily include "governmental use, consumption, or benefit" of the product at issue, there would have been no need to exclude government procurement of products "with a view to commercial resale or with a view to use in the production of goods for commercial sale" from the types of government procurement covered under Article III:8(a). This was because government procurement of a product for its own use, consumption or benefit could not, by definition, amount to procurement "with a view to commercial resale or with a view to use in the production of goods for commercial sale". (Paras 7.132-7.133)

(***Key Question:*** *Can the Government Procurement Agreement provide guidance in interpretation of the term 'procurement' for the purpose of Article III:8(a) of GATT 1994?*)

The Panel also agreed with Canada that Appendix I to the Government Procurement Agreement was not intended to provide a general definition of the term procurement, nor an interpretation of the term "procurement" within the meaning of Article III:8(a) of the GATT 1994. It was evident that the definition Canada had agreed to be bound by for the purpose of the GPA was not intended to define the scope of its rights and obligations under Article III:8(a) of the GATT 1994. (Paras 7.132-7.133)

Thus, the Panel found that for the purpose of Article III:8(a) of the GATT 1994, a "procurement by governmental agencies of products purchased" should be understood to refer to the action of a government of obtaining possession (including via obtaining an entitlement) over products through some kind of payment (monetary or otherwise). Moreover, in the light of this interpretation and its subsequent finding, that the challenged measures may be properly characterized as "government purchases [of] goods" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement, the Panel concluded that the measures at issue also involved "*procurement* by governmental agencies of products purchased" for the purpose of Article III:8(a) of the GATT 1994. (Para 7.136)

c. whether any "procurement" that existed was undertaken "for *governmental purposes* and not with a view to *commercial resale* or with a view to use in the production of goods for commercial sale".

"Governmental purposes"

With respect to the ordinary meaning of the expression "governmental purposes", the Panel first noted

that the parties had advanced a range of different meanings. At one end of the spectrum, Canada had proposed the broadest meaning, suggesting that a purchase for "governmental purposes" may exist whenever a government purchases a product for a stated aim of the government. At the other extreme, Japan advanced the narrowest meaning, submitting that a purchase for "governmental purposes" must be limited to purchases of products for governmental use, consumption or benefit. The EU took an intermediate position, proposing a meaning of "governmental purposes" that referred to government purchases for governmental needs, which included both the purchase of goods consumed by the government itself and those necessary for a government's provision of public services. (Para 7.138)

The Panel noted that the ordinary meaning of "governmental purposes" ("*les besoins des pouvoirs publics*" and "*las necesidades de los poderes públicos*", respectively in the French and Spanish versions) was relatively broad, and could have encompassed all three of the meanings advanced by the parties. It however observed that the expression must be interpreted within its context. In this regard, it found it particularly instructive to observe that the expression "governmental purposes" was immediately followed by the words "and not with a view to commercial resale or with a view to use in the production of goods for commercial sale." In the Panel's view, the plain language of Article III:8(a) suggested that a "procurement … of products purchased for governmental purposes" *cannot* also be a "procurement … of products purchased … with a view to commercial resale or with a view to use in the production of goods for commercial sale". In this regard, it saw the expression "and not with a view to commercial resale …" as serving to specifically inform and limit the otherwise relatively broad ordinary meaning of the term "governmental purposes". It was not convinced by Canada's arguments that the "governmental purposes" and "not with a view to commercial resale" language establishes *two* separate and cumulative requirements. (Paras 7.139-7.140)

The parties also argued that Article XVII:2 of the GATT 1994 served as relevant context for the interpretation of Article III:8(a), with Japan and the EU, in addition, submitting that the negotiating history of the two provisions supported their own interpretations of Article III:8(a). According to Canada, Article XVII:2 helped to demonstrate not only that "governmental purposes" in Article III:8(a) was not confined to "governmental consumption or use", but also that the "governmental purposes" and "not with a view to commercial resale" language established two cumulative conditions. it can be concluded from the text of Articles III:8(a) and XVII:2 that both provisions are intended to define the scope of the national treatment obligations in the context of two particular types of purchases: (i) purchases of products by governmental agencies (Article III:8(a)); and (ii) purchases of products through State Trading Enterprises (Article XVII:2).. (Paras 7.141-7.143)

(***Key Question:*** *Does Article XVII:2 of the GATT 1994 serve as relevant context for the interpretation of Article III:8(a)*?)

The Panel concluded from the text of Articles III:8(a) and XVII:2 that both provisions were intended to define the scope of the national treatment obligations in the context of two particular types of purchases: (i) purchases of products by governmental agencies (Article III:8(a)); and (ii) purchases of products through State Trading Enterprises (Article XVII:2). The Panel further stated that:

> "At first sight, the distinct language used to describe the types of relevant purchases that are covered by the two provisions could be interpreted to signify that Articles III:8(a) and XVII:2 were intended to cover a different range of transactions (not only because of the differences in the entities covered by the provisions). However, in our view, such a conclusion would not be completely accurate as it is evident from the language used in both provisions that there is, at the very least, significant overlap with respect to the types of purchases that are *excluded* from their terms of operation, namely, purchases "not with a view to commercial resale …" (under

> Article III:8(a)) and purchases "not otherwise for resale …" (under Article XVII:2). Thus, to the extent that the language of Article XVII:2 may serve as context for the interpretation of Article III:8(a), we find that it helps to confirm that a "procurement … of products purchased for governmental purposes" under Article III:8(a) cannot also be a "procurement … of products purchased … with a view to commercial resale or with a view to use in the production of goods for commercial sale"." (Para 7.144)

Thus, the Panel found that the term "governmental purposes" should be interpreted in juxtaposition to the expression "not with a view to commercial resale or with a view to use in the production of goods for commercial sale" that appeared in Article III:8(a). Thus, was the Panel to find that the procurement of electricity by the Government of Ontario under the FIT Programme was undertaken "with a view to commercial resale or with a view to use in the production of goods for commercial sale", such procurement would not be covered by Article III:8(a). (Para 7.145)

"Commercial resale"

The parties advanced different meanings of the expression "with a view to commercial resale" that appeared in Article III:8(a) of the GATT 1994. On the one hand, Canada argued that it meant a purchase with the aim to resell for profit. The complainants, on the other hand, submitted that "with a view to commercial resale" meant with a view to being sold or introduced into the stream of commerce, trade or market, regardless of any profit. (Para 7.146)

The Panel recalled that the Government of Ontario purchased electricity under the FIT Programme, through the FIT and microFIT Contracts. The purchased electricity was injected by generators into Ontario's electricity grid via transmission and distribution networks, and was eventually sold to consumers by Hydro One, local distribution companies ("LDCs") and private-sector licensed electricity retailers. Hydro One was a holding company wholly-owned by the Government of Ontario and an "agent" of the Government of Ontario. According to the Panel, it was evident that the electricity purchased by the Government of Ontario under the FIT Programme was resold to retail consumers through Hydro One and the LDCs in competition with private-sector retailers. The Panel was not convinced by Canada's argument that electricity purchased under the FIT Programme was not *resold* because of the fact that it was injected into Ontario's electricity grid, where it was pooled with electricity from other sources. The Panel also noted that the consideration of whether Ontario's electricity system was, as a whole, highly regulated or made up entirely of competitive markets at the different levels of trade did not change the basic fact that electricity purchased by the Government of Ontario under the FIT Programme was bought from generators and sold to retail consumers through the same channels as all other electricity by Hydro One and LDCs *in competition with private sector electricity retailers*. (Paras 7.147-7.148)

Canada further submitted that the Government of Ontario's purchases of electricity under the FIT Programme were not "with a view to commercial resale" because the OPA did not profit from the resale of electricity but simply recovered the cost of purchasing renewable electricity. However, whether the *OPA* profited from the Government of Ontario's purchases of electricity under the FIT Programme was not conclusive of whether any profit is made by the *Government of Ontario* on the resale of electricity to consumers. According to the Panel, to the extent that the service of electricity distribution was necessarily tied to and inseparable from the sale of electricity as a "commodity", there was no basis to conclude that the resale activities of Hydro One and almost all of the LDCs did not result in making profits. (Paras 7.149-7.150)

(***Key Question:*** *Does the term 'commercial resale' necessarily mean to resell for profit?*)

Having found that Hydro One and the LDCs sold electricity in competition with private-sector licensed retailers and that the Government of Ontario and the municipal governments profited from the resale of electricity purchased under the FIT Programme to consumers, it was clear to the Panel, for purposes of these disputes, that the nature of the resale of electricity purchased under the FIT Programme was "commercial". The Panel also stated that in coming to this conclusion, it emphasized that this did not mean it agreed with Canada's understanding that a "commercial resale" would always necessarily involve profit, as there may well be situations where a resale of a product purchased by a governmental agency may not involve a profit but still may be "commercial" for the purpose of Article III:8(a) of the GATT 1994. (Para 7.151)

Conclusion with respect to whether the challenged measures fall outside the scope of Article III:4 of the GATT 1994 by virtue of the operation of Article III:8(a) of the GATT 1994

The Panel thus concluded the following:

a. the Government of Ontario's purchases of electricity under the FIT Programme constituted "procurement", within the meaning of that term in Article III:8(a);
b. the "Minimum Required Domestic Content Level" prescribed under the FIT Programme, and effected through the FIT and microFIT Contracts, was one of the "requirements governing" the Government of Ontario's "procurement" of electricity; and
c. the Government of Ontario's "procurement" of electricity under the FIT Programme was undertaken "with a view to commercial resale".

In the light of this latter conclusion, the Panel found that the measures at issue were not covered by the terms of Article III:8(a), and that consequently, Canada could not rely on Article III:8(a) of the GATT 1994 to exclude the application of Article III:4 of the GATT 1994 to the "Minimum Required Domestic Content Level" that the complainants had challenged. (Para 7.152)

(ii) Whether the measures at issue were inconsistent with Article III:4 of the GATT 1994, and thereby also Article 2.1 of the TRIMs Agreement, by virtue of the operation of Article 2.2 of the TRIMs Agreement and Paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement

The Panel noted that Article 2.2 of the TRIMs Agreement prescribed that the TRIMs identified in Paragraph 1(a) of the Illustrative List in the Annex to the TRIMs Agreement were inconsistent with Article III:4 of the GATT 1994. Thus, where it was established that a measure fell within the scope of the obligations in Article III:4 of the GATT 1994, that measure may be found to be inconsistent with those obligations, and thereby also Article 2.1 of the TRIMs Agreement, if it shared the characteristics of the TRIMs described in Paragraph 1(a) of the Illustrative List. The EU argued that the measures at issue were covered by Paragraph 1(a) of the Illustrative List because: (i) compliance with the "Minimum Required Domestic Content Level" was necessary for generators to participate in the FIT Programme; and (ii) the "Minimum Required Domestic Content Level" required generators to purchase or use domestic renewable energy equipment and components. Japan also argued on similar lines. Given the parties' arguments, the Panel examined each of the elements separately.

Whether the "Minimum Required Domestic Content Level" required the purchase or use of products of Canadian origin or from a Canadian source

The FIT Rules defined the "Minimum Required Domestic Content Level" as the minimum percentage of

domestic content level set out on the FIT Contract cover page that should be achieved by contract facilities utilizing windpower with a contract capacity greater than 10 kW, or contract facilities utilizing solar PV. On reviewing the operation of the Minimum Required Domestic Content Level, the Panel found that the FIT Programme required FIT and microFIT electricity generators using solar PV technology and FIT generators using windpower technology to purchase or use a certain percentage of renewable energy generation equipment and components that were sourced in Ontario, and therefore "from a domestic source" within the meaning of Paragraph 1(a) of the Illustrative List. (Para 7.163)

Whether compliance with the "Minimum Required Domestic Content Level" was necessary in order to obtain an advantage

On the basis of the available evidence, the Panel concluded that it was evident that compliance with the "Minimum Required Domestic Content Level" was a necessary condition and prerequisite for electricity generators to participate in the FIT Programme. Moreover, because a failure to comply with the "Minimum Required Domestic Content Level" would place FIT and microFIT generators in default of their contractual obligations, it could also be concluded that the "Minimum Required Domestic Content Level" rendered the FIT and microFIT Contracts TRIMs that were "enforceable under domestic law", and they must also for this reason fall within the scope of the chapeau to Paragraph 1(a) of the Illustrative List. (Paras 7.164-7.166)

3. Conclusion with respect to the claims under Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994

In the light of its findings, the Panel concluded that the FIT Programme, and the FIT and microFIT Contracts, were inconsistent with Article 2.1 of the TRIMs Agreement and Article III:4 of the GATT 1994. (Para 7.167)

B. Whether the challenged measures constituted subsidies within the meaning of Article 1.1 of the SCM Agreement

1. Whether the challenged measures constituted a "financial contribution" and/or "income of price support" within the meaning of Article 1.1(a) of the SCM Agreement

Factual characterization of the measures

The FIT Programme:

The Panel noted that the FIT Programme had two fundamental objectives: first, to encourage the participation of new generation facilities using renewable sources of energy into Ontario's electricity system; and secondly, to stimulate local investment in the production of renewable energy generation equipment needed to design and construct qualifying generation facilities using solar PV and windpower technologies. These objectives were pursued through the execution of the FIT and microFIT Contracts, which involved an exchange of performance obligations on the part of the OPA and qualifying Suppliers. There was no inherent grant element to the FIT and microFIT transactions. (Para 7.216)

The FIT and microFIT Contracts:

The Panel stated that in essence, the FIT and microFIT Contracts envisaged an exchange of certain core performance obligations between Suppliers and the OPA. A Supplier must have designed, constructed, owned (or leased) and operated a qualifying facility in accordance with all relevant IESO Market Rules, laws and regulations. It should have also complied with the "Minimum Required Domestic Content

Level" when designing and constructing a solar PV or a microFIT windpower facility and delivered the electricity that was produced into the Ontario electricity system in accordance with all relevant IESO Market Rules, laws and regulations; and participated in a defined electricity payment processes to settle Contract Payments that is not unlike that used generally in Ontario's electricity system.

In return, the OPA agreed to make the Contract Payments, which were defined in such a way that ensured each Supplier would be remunerated via defined settlement processes at the guaranteed FIT Contract Price for each kWh of Delivered Electricity for 20 years. (Para 7.219)

Legal characterization of the measure

The complainants had argued that the challenged measures were properly characterized as one or multiple types of the "financial contribution(s)" defined in Article 1.1(a)(1) of the SCM Agreement and/or a form of "income or price support" within the meaning of Article 1.1(a)(2) of the SCM Agreement. On the other hand, Canada argued that the only appropriate characterization of the measures at issue was as "financial contribution(s)" in the form of "government purchases [of] goods" under the terms of Article 1.1(a)(1(iii) of the SCM Agreement.

i. <u>The challenged measures as financial contribution</u>

The Panel stated that because there was no dispute between the parties about whether each of the challenged measures amounted to a "financial contribution", it began by assessing the merits of the parties' arguments concerning the specific *types* of "financial contribution" they each considered match the salient characteristics of the challenged measures. (Para 7.220)

The Panel took the following into consideration.

a. *The OPA pays for "delivered electricity"*

Firstly, the Panel recalled that one of the fundamental objectives of the FIT Programme was to secure investment in new generation facilities for the purposes of diversifying Ontario's supply-mix and helping to fill the supply gap that was expected from the closure of Ontario's coal-fired facilities by 2014. It was by offering a Contract Price and making Contract Payments for Delivered Electricity that the Government of Ontario endeavoured to achieve this objective. The Panel observed that although the construction of a certain type of renewable energy generation facility was one of the objectives (and indeed, one of the conditions) of the challenged measures, the provisions of the FIT and microFIT Contracts expressly confirmed that the funds transferred to qualifying suppliers were intended to pay for the electricity that was delivered into Ontario's electricity grid. That the Contract Price was set at a level that was intended to provide a reasonable return on investment for the overall project did not alter the fact that under the express terms of the FIT and microFIT Contracts, Contract Payments would be made to solar PV and windpower generators only if electricity is delivered. Thus, according to the Panel, there was no grant element inherent in the design and operation of the FIT Programme. The OPA did not pay for renewable energy equipment or facilities, nor did it make any upfront lump-sum advances to the FIT generators: the OPA's payment liability was to arise only as and when electricity was produced and delivered into the system pursuant to the terms of the FIT and microFIT Contracts. (Paras 7.223 – 7.224)

b. *The Government of Ontario takes possession over electricity and therefore "purchases" electricity*

The Panel noted that the notion of "possession" was central to all definitions suggested by the parties. According to these suggestions, irrespective of the particular term used to explain what was meant by a

"purchase", it should necessarily have been understood as an act that, in the context of Article 1.1(a)(1)(iii) of the SCM Agreement, would result in the government "possessing" the good that was purchased. Furthermore, it followed from most of the above formulations, that the notion of a "purchase" for the purpose of Article 1.1(a)(1)(iii) involved some kind of payment (usually monetary) in exchange for a good. This latter proposition found support in US – Large Civil Aircraft (Second Complaint), where the Appellate Body observed that "[t]he second sub-clause [of Article 1.1(a)(1)(iii) of the SCM Agreement] uses the term 'purchase', which is usually understood to mean that the person or entity providing the goods will receive some consideration in return". (Para 7.227)

(***Key Question:*** Does the term 'purchase(s)' used in Article 1.1(a)(1)(iii) of the SCM Agreement necessarily involves obtaining physical possession over something?)

However, having said that, like Canada, the Panel observed that nothing in the ordinary meanings it had reviewed suggested that a "purchase" must involve obtaining physical possession over something. That a purchase of goods may take place through the transfer of an entitlement to a product was particularly important when considering what it meant to purchase electricity, which was an intangible good that, in general, could not be stored and must be consumed almost at the same time it is produced. Thus, given the specific characteristics of electricity, the Panel thought it best to conceive of a purchase of electricity as involving the transfer of an entitlement to electricity, rather than the taking of physical possession over electricity. (Paras 7.228-7.229)

Turning to the context of the term "purchases goods", the EU argued that the language of Article 1.1(a)(1)(iii) opposed the word "purchase" to the term "provision", and that this was instructive for the purpose of interpreting the former. The Panel however was not persuaded by this argument. In its view, there was little interpretative guidance to be drawn from the fact that the words "provides goods" and "purchases goods" appeared in the same sub-paragraph. (Para 7.230)

Furthermore, the Panel noted that "government purchases [of] goods" would arise under the terms of Article 1.1(a)(1)(iii) of the SCM Agreement when a "government" or "public body" obtained possession (including in the form of an entitlement) over a good by making a payment of some kind (monetary or otherwise). The Panel recalled that the provisions of the FIT and microFIT Contracts expressly confirmed that the funds transferred to qualifying suppliers were intended to pay for the electricity that was delivered into Ontario's electricity grid. According to the Panel, that the Government of Ontario had "meaningful control" over Hydro One's activities in a way that confirmed it was a "public body" within the meaning of Article 1.1(a)(1) of the SCM Agreement was evident from a number of more formal indicators. Starting with the statutory basis of Hydro One's incorporation, the Electricity Act of 1998, it noted that the Government of Ontario had not only imposed a duty on Hydro One to "operate generation facilities and distribution systems" and "distribute electricity" in "such communities" as the Government may prescribe, but it had also granted itself broad powers to define the "conditions and restrictions" pursuant to which such operations must be conducted. (Paras 7.231- 7.234)

Thus, this led to the conclusion that Hydro One was a "public body" for the purpose of Article 1.1(a)(1) of the SCM Agreement. In this regard, it was also important to recall that while the IESO (another "agent" of the Government of Ontario) had stated that it did not take any "title" to the electricity in the Ontario power grid, it nevertheless controlled how electricity flew through that grid. Thus, the Government of Ontario not only contracted with FIT Programme generators through the OPA to supply electricity into the grid, but it also directed the movement of that electricity to and throughout that grid by means of IESO instructions, and then finally, through the operations of Hydro One, transmitted and distributed the delivered electricity to end-user customers. In the Panel's view, the combined actions of all three "public bodies" (but especially Hydro One and the OPA) demonstrated that the Government of Ontario purchased

electricity within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement. Furthermore, according to the Panel, the fact that the FIT Contract contemplated the payment of generators for electricity supply that was foregone under IESO direction, did not take away from the characterization of the challenged measures as "government purchases [of] goods" (Paras 7.239-7.241)

c. *Legislation, regulations and contracts*

Finally, the Panel noted that the third consideration that had led it to the conclusion that the challenged measures constituted government purchases of goods was the legislative and regulatory framework of the FIT Programme as well as the language found in certain clauses of the FIT and microFIT Contracts themselves. In the Panel's view, these documents left no doubt that the challenged measures were perceived by the Government of Ontario, and others in Ontario, as governmental activity that involved the procurement or purchase of electricity. Thus, according to the Panel, while this evidence could not be the end of its analysis, the fact that the Electricity Act of 1998, the Ministerial Direction, the FIT and microFIT Contracts and other documents, all in one way or another characterized the challenged measures as a procurement or purchase of electricity, was a relevant factor that it took into account in its analysis. (Para 7.242)

d. *Conclusion*

Thus, for all of the foregoing reasons, the Panel concluded that the appropriate legal characterization to be given to the FIT Programme, and the FIT and microFIT Contracts, was as "government purchases [of] goods" under Article 1.1(a)(1)(iii) of the SCM Agreement. Although it did recognize that the challenged measures exhibited some of the basic features of certain forms of "direct transfer[s] of funds", in that they involved an exchange of rights and obligations which included the payment of money, it did not agree with the complainants that this meant they can *also* be legally characterized as such for the purposes of the SCM Agreement. In *US – Large Civil Aircraft (Second Complaint)*, the Appellate Body observed that a purchase of goods "is usually understood to mean that the person or entity providing the goods will receive some consideration in return". (Para 7.243)

The Panel thus noted that:

> "In our view, the fact that Article 1.1(a)(1)(iii) specifically identifies "goods" as the objects that a government will purchase is significant and reveals an intention on the part of the drafters to focus the relevant sub-clause of this provision on *only* this form of financial contribution. It is difficult to imagine that the drafters expressly referred to "purchases [of] *goods*" in Article 1.1(a)(1)(iii) of the SCM Agreement intending that such transactions should also be properly covered under Article 1.1(a)(1)(i) as "direct transfers of funds". In this regard, we observe that the only two examples of "direct transfer[s] of funds" involving reciprocal rights and obligations that Article 1.1(a)(1)(i) identifies are "loans" and "equity infusion[s]". Government "purchases of goods" could have easily been added to these examples had the drafters considered that they should also be viewed as falling within the scope of Article 1.1(a)(1)(i) of the SCM Agreement, particularly given that they are explicitly mentioned in Article 1.1(a)(1)(iii) of the SCM Agreement."

Furthermore, finding that the challenged measures may be legally characterized as "direct transfer[s] of funds" would, in the Panel's view, be contrary to the principle of effective treaty interpretation, which required an interpreter to refrain from adopting "a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility". It saw no way of reading Articles 1.1(a)(1)(i) and (iii) in a way that enabled it to conclude that government "purchases [of] goods" could also be legally characterized as "direct transfer[s] of funds" without infringing this principle. (Paras 7.244-7.246)

Finally, the complainants claimed that support for their views came from the following observation made by the Appellate Body *in a footnote* in *US – Large Civil Aircraft (Second Complaint)*:

> "The structure of [Article 1.1(a)(1)] does not expressly preclude that a transaction could be covered by more than one subparagraph. There is, for example, no 'or' included between the subparagraphs". It is apparent that the content of this footnote does not amount to a *finding* that transactions properly characterized as "purchases [of] goods" can also constitute "direct transfer[s] of funds".

The Panel noted that on this specific issue, the Appellate Body did not come to any definitive conclusion. Thus, while it could see that it may be possible to characterize different aspects of the same measure as different types of "financial contributions" (for example, a governmental programme involving loans and purchases of goods), it did not believe that customary rules of interpretation of public international law allowed to accept the interpretation advanced by the complainants. Having found that the challenged measures should be legally characterized as "government purchases of goods", and thereby rejecting that they amount to "direct transfer[s] of funds", the Panel also found that they could not be "potential direct transfers of funds". (Paras 7.247 – 7.248)

ii. <u>The challenged measures as a form of income or price support</u>

Both complainants in these proceedings had advanced essentially parallel arguments focused around the wholesale market for electricity to substantiate their assertions concerning the existence of "benefit", irrespective of whether the challenged measures were legally characterized under Articles 1.1(a) or 1.1(a)(2) of the SCM Agreement. In the section that follows, the Panel majority rejected the entirety of the complainants' "benefit" arguments as they related to Article 1.1(a)(1)(iii). It followed that the complainants' subsidy claims must also fail regardless of whether the Panel majority agreed with their contentions that the FIT Programme, and the FIT and microFIT Contracts, constituted a form of "income or price support" within the meaning of Article 1.1(a)(2) of the SCM Agreement. Therefore, on the grounds of judicial economy, it made no findings in respect of the complainants' allegations that the challenged measures may be legally characterized as "income or price support" under Article 1.1(a)(2) of the SCM Agreement. (Para 7.249)

C. Whether the challenged measure conferred a 'benefit' within the meaning of Article 1.1(b) of the SCM Agreement

Legal Standard for determining the existence of benefit

The Panel majority noted that a financial contribution would confer a benefit upon a recipient within the meaning of Article 1.1(b) of the SCM Agreement when it provided an advantage to its recipient. It was well established that the existence of any such advantage was to be determined by comparing the position of the recipient with and without the financial contribution, and that "the marketplace provides an appropriate basis for [making this] comparison". Article 14(d) of the SCM Agreement established guidelines for calculating the amount of subsidy in terms of benefit when there has been a government purchase of goods for the purpose of countervailing duty investigations. Thus, according to the Panel majority, in the context of the present disputes, Article 14(d) suggested that *one* way to demonstrate that the challenged measures conferred a benefit was by showing that the remuneration provided to FIT generators using windpower and solar PV technology to produce the electricity purchased by the OPA was "more than adequate" compared with the remuneration the same generators would receive on the "market" for electricity in Ontario, in the light of the "prevailing market conditions". According to the Panel majority, the starting point for this analysis was the identification of the relevant "market". (Para 7.272)

(***Key Question:*** *What are the factors relevant for consideration of a 'marketplace' under Article 14(d) of the SCM Agreement?*)

The Panel majority noted that in the specific context of Article 14(d), however, the relevant "marketplace" need not be one that was "undistorted by government intervention" or that excluded "situations in which there is government involvement". The relevant "market" need not be a "pure" marketplace that was devoid of any degree of government intervention or a "perfectly competitive" one in the sense of economic theory. Nevertheless, where a government's involvement as a provider of a particular good in a given market was such that "there is no way of telling whether the recipient is 'better off' absent the financial contribution", the market that was the object of the government intervention could serve as an appropriate benchmark for the purpose of Article 14(d). The Panel majority saw no reason why the same considerations should not also have applied to situations involving government *purchases* of goods. (Paras 7.273-7.275)

The wholesale market for electricity as the relevant focus of the benefit analysis

Fundamentally, the complainants' first and main line of benefit argument was that in the absence of the FIT Programme, a competitive wholesale market for electricity in Ontario could not support commercially viable operations of the contested FIT generators because the terms and conditions, including price, that would be attached to private purchases of electricity in such a market would expose them to significantly lower revenues and higher commercial risks compared with the terms and conditions associated with participation in the FIT Programme. To substantiate this argument, the complainants advanced a number of proposed competitive wholesale market electricity price benchmarks, or proxies for this benchmark that they submitted demonstrated that the FIT Programme provided "more than adequate remuneration" for the OPA's purchases of electricity under the FIT and microFIT Contracts. The complainants also focussed on the long-term (20-year) guaranteed pricing that was available under the FIT Programme, arguing that no such condition would be available from a private purchaser of electricity on the relevant market. (Para 7.276)

Canada accepted that "most" of the contested FIT generators would be unable to conduct viable operations in a competitive wholesale market for electricity in Ontario. However, Canada rejected the view that this demonstrated that the OPA's purchases of electricity under the FIT Programme conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement. Canada explained that the OPA's purchases of electricity, including from renewable energy generators under the FIT Programme, had been motivated by the inability of Ontario's wholesale electricity market to encourage the investment in new electricity generation facilities needed to secure a reliable and clean supply of electricity that was sufficient to meet Ontario's long-term requirements (i.e. the "missing money" problem). Canada emphasized that given the different costs associated with the different technologies that must operate to achieve this objective, the most appropriate benchmark for the Panel majority's benefit analysis in relation to the FIT and microFIT Contracts reflected what it considered to be the fundamental condition for the Government of Ontario's purchases of electricity under the FIT Programme, namely, that the electricity be produced from renewable energy sources. Thus, Canada submitted that the relevant "market" comparator must be the market for electricity produced from wind and solar PV generation technologies. (Para 7.277)

<u>The economics of electricity markets and the "missing money" problem</u>

The Panel majority stated that as it had previously explained, electricity had some specific properties compared to other types of goods. It was intangible and, with some limited exceptions, could not be effectively stored. It was also delivered to consumers through networks of transmission and distribution lines that could fail if the quantity demanded (known as load) was greater or less than the quantity

supplied for any length of time. These properties implied that electricity must be produced at the time that it was consumed, and that the flow of electricity through a transmission grid could not be left to the choices of individual market participants, but rather it must be centrally coordinated and controlled. As usual, the intersection of supply and demand determined the market clearing price and quantity of electricity. However the steepness of both curves in typical electricity markets suggested that prices may be extremely volatile, rising or falling sharply in response to small changes in demand and/or supply. According to the Panel majority, one of the main reasons for this was the complexity of incorporating appropriate demand-side responsiveness to supply-side price signals in times of scarcity - or, in other words, the difficulty of equipping electricity consumers with the information and means they need to respond to electricity supply constraints in real-time. (Paras 7.278-7.282)

In the absence of demand that was more responsive (but not only for this reason), governments and regulators had sought to control potential/actual price volatility by intervening in the market because of the value of stable electricity prices to their economies, with the consequence that many countries had experienced insufficient investment in generation because the price achieved on their "organized" wholesale market was not allowed to rise to a level that, in the long-run, fully compensated generators for the all-in cost of their investments (including fixed and sunk costs). Private investors would not be willing to finance construction of new generation under such conditions; and in the absence of such investment, an electricity market would have been unable to reliably meet future electricity demand. This was referred to as the "missing money" problem and it affected not only more expensive solar PV and wind generation technologies, but also "conventional generating technologies, where energy-only markets did not support investment". To resolve this dilemma, "alternative mechanisms to wholesale spot markets have been required to provide incentives for long-term investment to meet forecasted demand", including power purchase agreements (as in Ontario) and "capacity" payments. (Paras 7.282-7.283)

Ontario's 2002 wholesale electricity market experience

The complainants asserted that a competitive wholesale market for electricity existed in Ontario in 2002. Canada accepted that such a market existed between May and November 2002. During this seven month period, electricity generated from facilities accounting for 94% of Ontario's generation capacity was bought and sold on the wholesale market at prices set through a market clearing mechanism administered by the Independent Market Operator. Canada explained that over the summer of 2002, very high temperatures drove up demand to levels that could not be satisfied by existing suppliers without significant price increases. Between May and November 2002, prices rose by an average of over 30%. Canada attributed the inability of suppliers to respond to the spike in demand without significant price increases to the "market structure" that existed during this period, amongst others. Thus, according to the Panel majority, it appeared that in addition to the price volatility problems associated with the inherent attributes of competitive wholesale electricity markets, a combination of other factors shaping the interaction of supply and demand for electricity in Ontario affected the operation of the competitive wholesale market that existed between May and November 2002, creating critical limits on what it could achieve. According to Canada, the 2002 experience demonstrated that a competitive wholesale electricity market "would not be sufficient to encourage the construction of new generation facilities able to provide the additional long-term supply needed by Ontario residents. (Paras 7.284-7.289)

Thus, in the Panel majority's view, Ontario's 2002 market opening experience confirmed what was suggested in the Hogan Report, namely, that competitive wholesale electricity markets would only rarely attract sufficient investment in the generation capacity needed to secure a reliable supply of electricity. The evidence indicated that this universal objective of all electricity systems could not have been achieved in Ontario in 2002 solely on the basis of the operation of a competitive wholesale electricity market. (Para 7.291)

The IESO-administered wholesale electricity market

Japan asserted that the current IESO-administered wholesale electricity market was a competitive wholesale electricity market. Japan argued that normal market forces, including supply and demand, and the cost of production, came together in this market to set wholesale electricity prices (i.e. the HOEP or Hourly Ontario Electricity Price). However, the Panel majority noted that the price offers attached to a generator's supply bids in the IESO-administered wholesale market were not motivated by the need to cover marginal costs of production (as would typically be the case in a competitive wholesale electricity market such as that which existed in Ontario in 2002), but rather by the need for each generator to be chosen to supply electricity into the Ontario grid in order to receive its contracted or regulated prices. Thus, the IESO-administered wholesale market did not arrive at its equilibrium price (the HOEP) through forces of supply and demand that were unaffected by the policies of the Government of Ontario. (Para 7.292-7.297)

Moreover, the EU submitted that "one possible means to assess whether the HOEP represented the price of electricity in Ontario under market conditions" was to compare it with the prices of Ontario electricity imports and exports. The Panel majority, however, recalled that the HOEP did not represent an equilibrium price that was set in a competitive wholesale market of a kind that may be used for the purpose of conducting the present benefit analysis. Exporters of electricity would supply to Ontario when the difference between wholesale prices in different jurisdictions was "large enough" to warrant arbitrage between the two systems, it followed that the price level in an exporter's domestic wholesale market would significantly influence the price of exports. Thus, according to the Panel majority, in this light, the fact that the HOEP was similar to export and import prices could simply reflect the existence of less than competitive wholesale markets in the neighbouring jurisdictions. (Paras 7.298 -7.301)

Wholesale electricity markets outside of Ontario

The complainants argued that the price of electricity in four allegedly competitive wholesale electricity markets operating outside of Ontario could be used as a proxy for the wholesale market price of electricity in Ontario. In particular, the complainants referred to the prices established in the wholesale electricity markets of Alberta, New York State, the State of New England and the Mid-Atlantic region of the United States (the PJM Interconnection). The Panel majority noted that the Hogan Report had identified New York, New England and PJM as examples of regions that operated capacity markets to supplement spot market revenues for electricity and ancillary services. In other words, the wholesale spot market prices for electricity in New York, New England and PJM, were not the only sources of revenue for generators supplying electricity into their respective systems. Generators in these systems also received "capacity" payments. Thus, not unlike Ontario's market opening experience in 2002, the fact that generators in New York, New England and PJM operate on the basis of more than just the revenues obtained from the wholesale spot market for electricity evidenced the difficulties that competitive wholesale markets had to, *on their own*, attract sufficient investment in the generation capacity needed to secure a reliable system of electricity supply. (Para 7.302-7.304)

Turning to the complainants' reference to the Province of Alberta, the Panel majority observed that the fact that a "market" approach "has had some success in Alberta" was noted by Canada's Electricity Conservation and Supply Task Force ("ECSTF"). However, in the light of *inter alia* the conditions of supply and demand forecasted to exist in Ontario between 2003 and 2020, the ECSTF had concluded that following the same approach in Ontario involved risks that "were simply too great". (Para 7.305)

Conclusions concerning the wholesale electricity market as the relevant focus of the benefit analysis

Thus, the Panel majority concluded the following:

a) the HOEP was a price set through the interaction of supply and demand forces that in many critical aspects were significantly influenced by the supply-mix and pricing policy decisions and regulations of the Government of Ontario, and therefore, the HOEP and all of the related HOEP-derivatives the complainants had submitted as appropriate benchmarks for the purpose of the benefit analysis could not be accepted;

b) the complainants had failed to convince that, in the absence of the FIT Programme, the FIT generators would be faced with having to operate in a competitive wholesale electricity market because: (i) the economics of competitive wholesale electricity markets suggested that they would only rarely attract the degree of investment in the generation capacity needed to secure a reliable electricity system; and (ii) the weight of the evidence indicated that, at present, a competitive wholesale electricity market would fail to achieve this outcome in Ontario; and

c) in the light of the conclusions in (a) and (b), and given the critical importance of electricity to all facets of modern life, the Panel majority found that the question whether the challenged measures conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement could not be resolved by applying a benchmark that was derived from the conditions for purchasing electricity in a competitive wholesale electricity market. (Para 7.312)

Alternate to the wholesale market for electricity as the relevant focus of the benefit analysis

Both Japan and the EU had advanced a number of alternative benchmarks to the competitive wholesale electricity market which they considered may be used to demonstrate that the challenged measures conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement. The Panel majority found that none of the alternatives that had been advanced by the complainants (or Canada) may have been used as appropriate benchmarks against which to measure whether the FIT Programme and the FIT and microFIT Contracts conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement. In particular, it determined that the HOEP would not be the only option available to potential generators using solar PV and windpower technology in the absence of the FIT Programme. The HOEP could not therefore be used to test whether the FIT and microFIT Contract Prices conferred a benefit upon FIT Programme generators. The two other alternatives advanced by the complainants (electricity import and export prices, and RPP (Regulated Price Plan) prices) were both inherently connected to the HOEP and, thereby, the electricity pricing policy decisions and regulations of the Government of Ontario. Therefore, these alternatives also could not be relied upon to determine whether the FIT Programme conferred a benefit. Finally, the Panel majority found that there was no evidence to support the existence in Ontario of a separate wholesale market for electricity that was generated solely from solar PV and windpower technology. There was therefore no factual basis to support Canada's contention that the existence of benefit could have been determined in the present disputes by comparing FIT and microFIT Contract Prices with the prices established in such a market. (Para 7.318)

Final conclusion and observations on the existence of benefit

The Panel majority thus concluded that it was only in exceptional circumstances that the generation capacity needed from all such technologies would be attracted into a wholesale market operating under the conditions of effective competition. Thus, the competitive wholesale electricity market that was at the centre of the complainants' main submissions could not be the appropriate focus of the benefit analysis in these disputes. Furthermore, for the reasons it had outlined, the alternatives to the wholesale electricity

market that had been presented to also could not stand as appropriate benchmarks against which it could be measured whether the challenged measures conferred a benefit. There was therefore, according to the Panel majority, no basis to uphold the complainants' benefit arguments.

(***Key Question:*** *Is a panel under an obligation to review the merits of claims on the basis of the arguments that had not been submitted by the complainant themselves?)*

In coming to this conclusion, the Panel majority also noted that the complainants had asked the Panel majority to not limit its analysis to rejecting the benchmarks proposed by the parties, inviting the Panel majority to "find the appropriate benchmark to make a finding on the existence or absence of benefit" and "identify the proper benchmark to complete the benefit analysis". According to the EU, the Panel majority was under an obligation to do so. The Panel majority however stated that:

> "In our view, there is no authority in WTO law that *compels* us to review the merits of the complainants' prohibited subsidy claims on the basis of arguments that they have not themselves advanced. We are not convinced that the passages the European Union has referred to from the Appellate Body report in *Japan – DRAMS* and the panel report in *Canada – Aircraft*, stand for the proposition that the Panel majority in these disputes cannot limit its analysis to rejecting the complainants' benefit arguments. Moreover, we recall that it has been consistently recognized in WTO dispute settlement practice that it is for a complaining party to establish a claimed infringement of the covered agreements by presenting at least a *prima facie* case of violation on the basis of relevant legal and factual arguments. Thus, while a panel has a duty to engage with and explore such arguments and make objective findings upon their merits, a panel is not entitled to make a *prima facie* case for a party that bears the burden of making it. (Para 7.320)

Because the Panel majority had found that the very existence of a reliable electricity supply in Ontario at present required comprehensive government intervention in the wholesale electricity market, it observed that one way it was possible to evaluate whether the challenged measures conferred a benefit, that at the same time maintained a market-based discipline, was by evaluating the commercial nature of the FIT and microFIT Contracts against the actions of private purchasers of electricity in a wholesale market where the conditions of supply and demand mirrored those that currently exist in Ontario. Thus, one such way to determine whether the challenged measures conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement would involve testing them against the types of arm's length purchase transactions that would exist in a wholesale electricity market whose broad parameters were defined by the Government of Ontario. In the present set of circumstances, this could be done by comparing the terms and conditions of the challenged FIT and microFIT Contracts with the terms and conditions that would be offered by commercial distributors of electricity acting under a government-imposed obligation to acquire electricity from generators operating solar PV and windpower plants of a comparable scale to those functioning under the FIT Programme. (Para 7.321)

The Panel majority observed that in general, this meant that a distributor would endeavour to enter into a supply contract with any electricity generator that had the lowest overall net cost. The Panel majority was of the view that one approach to determining whether the challenged measures conferred a benefit could be to compare the *rate of return* obtained by the FIT generators under the terms and conditions of the FIT and microFIT Contracts with the average cost of capital in Canada for projects having a comparable risk profile in the same period. The Panel majority noted that the rate of return of a particular project involving the investment of capital was a measure of the extent to which that project realized a profit (or loss). It appeared, therefore, that the record of these disputes did not contain any appropriate information that could be used to determine the average cost of capital in Canada for projects with a comparable risk profile to the challenged FIT and microFIT projects during the relevant period. Thus, the Panel majority concluded that while it believed that a comparison between the relevant rates of return of the challenged

FIT and microFIT Contracts with the relevant average cost of capital in Canada would be a useful way to determine, on the basis of the benefit standard it had outlined, whether the challenged measures conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement, a number of important questions and factual issues would need to be explored and resolved in order for any such analysis to be undertaken. (Paras 7.322-7.326)

D. Overall Conclusion

The Panel majority thus concluded that:

a) the FIT Programme, and the FIT and microFIT Contracts, amounted to government purchases of goods within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement; and
b) Japan and the EU had failed to establish that the challenged measures conferred a benefit, within the meaning of Article 1.1(b) of the SCM Agreement. (Para 7.327)

III. DISSENTING OPINION OF ONE MEMBER OF THE PANEL WITH RESPECT TO WHETHER THE CHALLENGED MEASURES CONFER A BENEFIT WITHIN THE MEANING OF ARTICLE 1.1(B) OF THE SCM AGREEMENT

In the dissenting opinion it was observed that the wholesale electricity market that currently existed in Ontario was recognizable as a market for the buying and selling of electricity. It was undeniable that the supply of electricity, its price and competition between electricity generators – in particular, market entry – were very heavily regulated and conditioned in the market by the Government of Ontario. The wholesale electricity market that currently existed in Ontario was therefore not the kind of market where price was determined by the unconstrained forces of supply and demand. It was further noted that the regulatory impacts on the market were not simply in the nature of framework regulation, within which those forces may operate. The Government of Ontario (through Hydro One) and the municipal governments (through Local Distribution Companies) accounted for almost all purchases of electricity made at the wholesale level.

The competitive wholesale electricity market is the relevant focus of the benefit analysis

It was noted that the Panel majority had concluded that the wholesale electricity market currently operating in Ontario could not be used for the purpose of conducting the benefit analysis. In addition, the Panel majority had found that the competitive wholesale electricity market that could, in theory, existed in Ontario could also not be used as a basis for the benefit analysis because, in the light of the prevailing conditions of supply and demand, such a market would fail to attract the generation capacity needed to secure a reliable supply of electricity for the people of Ontario. According to the dissenting panellist however, the fact that a competitive market might not exist in the absence of government intervention or that it may not achieve all of the objectives that a government would like it to achieve, did not mean it could not be used for the purpose of conducting a benefit analysis. Indeed, it was because competitive markets did not often work the way that governments would like them to that governments would decide to influence market outcomes by, for example, becoming a market participant, regulating market participants or providing them with incentives (or creating disincentives) to behave in a particular way. (Para 9.5)

Whether the challenged measures provide for "more than adequate remuneration" within the meaning of article 14(d) of the SCM Agreement

The dissenting panellist noted the following on the issue:

a. It was stated that it was important to recall that the guidelines in Article 14(d) of the SCM

Agreement stipulated that the amount of benefit may be calculated by identifying the extent to which "more than adequate remuneration" had been paid for a purchased product "in relation to prevailing market conditions" in the country of purchase. In the present disputes, the complainants had not advanced country-specific price benchmarks, but rather benchmarks based on prices established in regional intra-national markets operating in Canada, and also the US. The complainants appear to have done so because there are no national electricity wholesale markets in Canada. In other words, the "prevailing market conditions" in the country of purchase (Canada) are such that there were no country-wide electricity markets. Article 14(d) did not suggest that the prevailing market conditions could only be those of a national market. Market conditions in a regional market of a country are, relevantly, market conditions "in the country of purchase". In this light, the complainants' approach was not inconsistent with the guidelines stipulated in Article 14(d) of the SCM Agreement. (Para 9.9)

b. The competitive nature of the IESO-administered wholesale electricity market in Ontario was closely examined by the Panel majority, which found that the equilibrium level of the HOEP that was set in this market was directly related to the electricity pricing policy and supply-mix decisions of the Government of Ontario. The dissenting panellist agreed with this finding of the Panel. (Para 9.10)

c. The complainants had also presented the prices for electricity paid in four allegedly competitive wholesale electricity markets outside of Ontario as proxies for the wholesale market price of electricity in Ontario, and argue that these prices demonstrate that the challenged measures confer a benefit. They were prices in Alberta, Canada (the "Alberta benchmark") and prices in New York, New England, and the PJM Interconnection (the "US benchmarks"). It was noted that in *US - Softwood Lumber IV*, the Appellate Body had found that where private prices for a particular good provided by a government were "distorted because of the government's predominant role in providing those goods", Article 14(d) of the SCM Agreement permitted investigating authorities to use the price of the same or similar goods in a market outside of the country in question as a benchmark for conducting a benefit analysis. Thus, according to the dissenting panellist, the complainants had failed to make any adjustments to the out-of-Province prices to account for these and other "prevailing market conditions" in Ontario, nor had they adequately explained away why such adjustments need not be made. Thus, the evidence was not in a sufficient state to enable the Panel to conduct the benefit analysis under the terms of Article 14(d) of the SCM Agreement in the way the Appellate Body has insisted that it should be conducted. (Paras 9.10-9.16)

Whether the challenged measures enabled solar PV and windpower generators to conduct viable operations and thereby participate in the wholesale electricity market

The second line of benefit argument advanced by the complainants was focused on the very nature and objectives of the FIT Programme. In particular, the complainants submitted that the FIT Programme was created and operated for the purpose of allowing generators of electricity from renewable sources of energy, including solar and wind, to supply electricity into the Ontario electricity system because a competitive wholesale electricity market could not support such high cost producers. According to the dissenting opinion, by contracting to purchase electricity produced from solar PV and windpower technologies under the FIT Programme at a price intended to provide for a reasonable return on the investment associated with a "typical" project, the Government of Ontario had ensured that qualifying generators were remunerated at a level that allowed them to recoup the entirety of their "very high" capital costs. As the complainants argued and Canada had accepted, such levels of remuneration would never be achieved through the unconstrained forces of supply and demand in a competitive wholesale electricity market in Ontario. Nor could they be achieved within the constrained forces of supply and demand which actually did operate within the wholesale electricity market in Ontario, without an intervention which remunerated the facilities which generated power from solar PV and windpower

technologies at a higher rate than was paid in respect of electricity generated by the other technologies. (Paras 9.17-9.23)

IV. DISPUTE NOTES ON SELECT ISSUES

- Sources of International Law:
  The Panel in its analyses has mainly relied on treaty text (viz. the *SCM Agreement*, the *TRIMs Agreement* and *GATT 1994*) and the previous relevant Panel/ Appellate Body Reports.

- Article III:8(a) of the GATT 1994:
  This is the first dispute where a panel was requested to interpret and apply Article III:8(a) of the GATT 1994. Article III:8(a) states that the "...provisions of this Article shall not apply to laws, regulations or requirements governing the *procurement* by government agencies of products purchased *for governmental purposes* and *not with a view to commercial resale* or with a view to use in the production of goods for commercial sale." The Panel noted that any government transaction covered by the Article III:8(a) of the GATT 1994 would be removed from the scope of the obligations set out in Article III, including Article III:4. Importantly, the Panel also found that where a particular TRIM involved the same kind of transactions described in Article III:8(a), it could not found to be inconsistent with the obligation in Article 2.1 of the TRIMs Agreement.

  In reaching the above conclusion, the Panel made important findings relating to different elements of the Article III:8(a) of GATT 1994. On the meaning of the term "*procurement*", the Panel noted that if the notion of "procurement" that was referred to in Article III:8(a) were interpreted to necessarily include "governmental use, consumption, or benefit" of the product at issue, there would have been no need to exclude government procurement of products "with a view to commercial resale or with a view to use in the production of goods for commercial sale" from the types of government procurement covered under Article III:8(a). On the meaning of "*governmental purposes*", the Panel noted that the same should be interpreted in juxtaposition to the expression "not with a view to commercial resale or with a view to use in the production of goods ", and such procurement would not be covered by Article III:8(a), and hence turned to examine whether the measure at issue in the current dispute involved a government purchase "with a view to commercial resale".

  On the meaning of the term "*commercial resale*", a key observation made by the Panel was that it did not agree with the understanding that a "commercial resale" would always necessarily involve profit, as there may well be situations where a resale of a product purchased by a governmental agency may not involve a profit but still may be "commercial" for the purpose of Article III:8(a) of the GATT 1994.

- 'Financial contribution' under Article 1.1(a) of the SCM Agreement
  Interestingly, while the complainants had argued that the challenged measures amounted to a 'financial contribution' in the form of a 'direct transfer of funds' or a 'potential direct transfer of funds' under Article 1.1(a)(1)(i) of the SCM Agreement, the Panel found the presence of financial contribution, albeit of a different form. According to the Panel, the measures amounted to financial contribution by virtue of government 'purchase' of goods falling under Article 1.1(a)(1)(iii) of the SCM Agreement. The Panel also declined to look at the alternate submission made by complainants relating to the measures amounting to 'income or price support' on grounds of judicial economy.

- 'Benefit' under Article 1.1(b) of the SCM Agreement:
  It is imperative to note that while the majority panel rejected the existence of benefit within the

meaning of Article 1.1(b) of the SCM Agreement, its findings were based on the inability of complainants to provide appropriate benchmark for a benefit analysis.

The Panel however did observe that the very existence of a reliable electricity supply in Ontario at present required comprehensive government intervention in the wholesale electricity market, it observed that one way it was possible to evaluate whether the challenged measures conferred a benefit, that at the same time maintained a market-based discipline, was by evaluating the commercial nature of the FIT and microFIT Contracts against the actions of private purchasers of electricity in a wholesale market where the conditions of supply and demand mirrored those that currently exist in Ontario. The Panel was of the view that one approach to determining whether the challenged measures conferred a benefit could also be to compare the *rate of return* obtained by the FIT generators under the terms and conditions of the FIT and microFIT Contracts with the average cost of capital in Canada for projects having a comparable risk profile in the same period.

Thus, the Panel concluded that while it believed that a comparison between the relevant rates of return of the challenged FIT and microFIT Contracts with the relevant average cost of capital in Canada would be a useful way to determine, on the basis of the benefit standard it had outlined, whether the challenged measures conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement, a number of important questions and factual issues would need to be explored and resolved in order for any such analysis to be undertaken.

- Dissenting opinion:
  The present dispute is one of those rare disputes in the working of the WTO disputes settlement mechanism, where a dissenting opinion has been given one member of the Panel. The dissenting opinion differed with the majority panel with respect to whether the challenged measures conferred a benefit within the meaning of Article 1.1(b) of the SCM Agreement.