WTO Subsidies Agreement:

Jurisprudence

On

Key Concepts

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AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES (SCM AGREEMENT)

1. ARTICLE 1:

1.1. Article 1
(Can subsidies be defined as benefits resulting from *any* government action?)

In the dispute of *US - Exports Restraints*, the Panel considered the negotiating history of "financial contribution" and concluded that:

> "Article 1 as ultimately adopted incorporates the requirement of a financial contribution by a government or other public body as a necessary element of a subsidy. The submissions by participants to the negotiations suggest that the proponents' purpose behind including this element was to limit the kinds of government actions that could fall within the scope of the subsidy and countervailing measure rules. In other words, the definition ultimately agreed in the negotiations definitively rejected the approach espoused by the United States of defining subsidies as benefits resulting from any government action, by introducing the requirement that the government action in question constitute a "financial contribution" as set forth in an exhaustive list." (Para 8.69)

1.2. Article 1
(Purpose of introducing a two part definition of subsidy comprising "financial contribution" and "benefit")

In the dispute of *US - Exports Restraints*, the Panel considered the negotiating history and concluded that:

> "In short, the negotiating history confirms that the introduction of the two-part definition of subsidy, consisting of "financial contribution" and "benefit", was intended specifically to prevent the countervailing of *benefits* from any sort of (formal, enforceable) government measures, by restricting to a finite list the *kinds* of government measures that would, if they conferred benefits, constitute subsidies. The negotiating history confirms that items (i)-(iii) of that list limit these kinds of measures to the transfer of economic resources from a government to a private entity. Under subparagraphs (i)-(iii), the government acting on its own behalf is effecting that transfer by directly providing something of value – either money, goods, or services – to a private entity. Subparagraph (iv) ensures that the same kinds of *government* transfers of economic resources, when undertaken through explicit *delegation of those* functions to a private entity, do not thereby escape disciplines." (Para 8.73)

1.3. Article 1.1
(Is any obligation imposed by Article 1.1?)

In the dispute of *US – FSC Article 21.5*, the Appellate Body was of the view that:

> "Article 1.1 of the *SCM Agreement* sets out a *definition* of a "subsidy" for the purposes of that Agreement. Although this definition is central to the applicability and operation of the remaining provisions of the Agreement, Article 1.1 itself does not impose any obligation on Members with respect to the subsidies it defines. It is the provisions of

the *SCM Agreement* which follow Article 1, such as Articles 3 and 5, which impose obligations on Members with respect to subsidies falling within the definition set forth in Article 1.1."(Para 85)

1.4. <u>Article XVI:4 of GATT 1994 and Article 1.1 of SCM Agreement</u>
(Relationship between Article XVI:4 of GATT 1994 and Article 1.1)

In the dispute of *US- FSC*, according to the Appellate Body:

> "The *SCM Agreement* contains an express definition of the term "subsidy" which is not contained in Article XVI:4. In fact, as we have observed previously, the *SCM Agreement* contains a broad package of new export subsidy disciplines that "go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947". (Para 117)

1.5. <u>Article 1.1</u> ("For the purpose of this Agreement, a subsidy shall… exist")
(Is the definition of "subsidy" in Article 1.1 applicable throughout the *SCM Agreement*?)

In the dispute of *US- FSC*, an issue before the Appellate Body was whether the word "subsidy" as defined in Article 1.1 is applicable in the entire *SCM Agreement* or it is qualified by various exceptions to the general interpretation of "subsidy". It was the view of the Appellate Body that:

> "Article 1.1 sets forth the general definition of the term "subsidy" which applies "for the purpose of this Agreement". This definition, therefore, applies wherever the word "subsidy" occurs throughout the SCM Agreement and conditions the application of the provisions of that Agreement regarding prohibited subsidies in Part II, actionable subsidies in Part III, non-actionable subsidies in Part IV and countervailing measures in Part V." (Para 93)

1.6. <u>Article 1.1 (a) (1)</u> ("public body")
(Does the term "public body" include an organization that carries on a business equivalent to that of a private operator?)

In the dispute of *Korea – Commercial Vessels*, the European Communities argued that Export – Import Bank of Korea (KEXIM) was a public body for the purposes of Article 1 of the *SCM Agreement* as it was created and operated on the basis of a public statute. Moreover, the control over its decision making rested with the Government of Korea and KEXIM benefited from its access to state resources. Korea, in response, refuted these claims and argued that an organization is a public body only when it acts in an official capacity or is engaged in governmental functions and not when it carries on a business equivalent to that of a private operator.

The Panel rejected Korea's argument and stated that:

> "By asserting that an entity will not constitute a "public body" if it engages in market (non-official) activities on commercial terms, Korea is essentially arguing that we should apply the "benefit" test (whereby a "financial contribution" only confers a "benefit" if it was made available on terms more favourable than the recipient could have obtained on the market). The Appellate Body ruled in *Brazil – Aircraft* that "the issues – and the respective definitions – of a 'financial contribution' and a 'benefit' [are]

> ... two separate legal elements". Likewise, we consider that the concepts of "public body" and "benefit" should also be treated as separate legal elements. Thus, the question whether an entity is a public body should not depend on an examination of whether that entity acts pursuant to commercial principles. Rather, it is the fact that a financial contribution is provided by a public body (or pursuant to entrustment or direction by a public body) that gives rise to the possibility that the financial contribution might be provided on below-market terms in order to advance public policy goals." (Para 7.44)

The Panel further noted that it could not accept Korea's approach because it would mean that at different times, the same financial entity could be both a public and a private body, depending on how that entity was conducting itself in the market. According to the Panel, an entity would constitute a "public body" if it was controlled by the government (or other public bodies). If an entity was controlled by the government (or other public bodies), then any action by that entity was attributable to the government and would therefore fall within the scope of Article 1.1(a)(1) of the *SCM Agreement*. *This interpretation has been modified by the Appellate Body in US – CVD China (AB), Refer 1.8 below*)Thus, KEXIM was held to be a "public body" because it was controlled by the Government of Korea as it was 100 per cent owned by the Government of Korea or other public bodies. (Paras 7.45 – 7.50)

1.7. Article 1.1 (a) (1) ('public body')

(Is control of an entity by government sufficient to establish that the entity is a public body?)

In the dispute of *US-CVD China (AB)*, China appealed before the Appellate Body contending that the Panel had erred in its interpretation of 'public body' by considering government ownership to be highly relevant and potentially dispositive evidence of government control. The Appellant Body concluded that the Panel's analysis lacked proper legal basis as the mere fact that a government is the majority shareholder of an entity does not demonstrate that the government exercises meaningful control over the conduct of that entity, much less that the government has bestowed it with governmental authority. Further, it disagreed with the Panel's reasoning that the use of the collective term "government" has no meaning besides facilitating the drafting of the Agreement and that the words "a", "or", and "any" within the phrase "a government or any public body" indicated that "government" and "public body" are separate concepts with distinct meanings. It further noted:

> "Turning then to the question of what essential characteristics an entity must share with government in the narrow sense in order to be a public body and, thus, part of government in the collective sense, we note, that the term "government" is defined as the "continuous exercise of authority over subjects; authoritative direction or regulation and control". In this vein, the Appellate Body found, in *Canada – Dairy*, that the essence of government is that it enjoys the effective power to regulate, control, or supervise individuals, or otherwise restrain their conduct, through the exercise of lawful authority. The Appellate Body further found that this meaning is derived, in part, from the functions performed by a government and, in part, from the government having the powers and authority to perform those functions. As we see it, these defining elements of the word "government" inform the meaning of the term "public body". *This suggests that the performance of governmental functions, or the fact of being vested with, and exercising, the authority to perform such functions are core commonalities between government and public body.* (Para 290)

Thus a public body may exercise its authority in order to compel or command a private body, or govern a private body's action (direction) and may give responsibility for certain tasks to a private body (entrustment). The Appellate Body thus elaborated that:

> "As we see it, for a public body to be able to exercise its authority over a private body (direction), a public body must itself possess such authority, or ability to compel or command. Similarly, in order to be able to give responsibility to a private body (entrustment), it must itself be vested with such responsibility." (Para 294)
> …
>
> We see the concept of "public body" as sharing certain attributes with the concept of "government". A public body within the meaning of Article 1.1.(a)(1) of the SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority. Yet, just as no two governments are exactly alike, the precise contours and characteristics of a public body are bound to differ from entity to entity, State to State, and case to case. Panels or investigating authorities confronted with the question of whether conduct falling within the scope of Article 1.1.(a)(1) is that of a public body will be in a position to answer that question only by conducting a proper evaluation of the core features of the entity concerned, and its relationship with government in the narrow sense.
>
> We recall that the Panel interpreted the term "public body" in Article 1.1(a)(1) of the SCM Agreement to mean "any entity controlled by a government". We note that the Panel did not further clarify its notion of control, although it considered government ownership to be "highly relevant (indeed potentially dispositive)". In that context, the Panel relied on the "everyday financial concept of a 'controlling interest' in a company". The above analysis, however, indicates that control of an entity by a government, in itself, is not sufficient to establish that an entity is a public body." (Paras 320-322)

1.8. <u>Article 1.1 (a) (1) (i)</u> ("government practice")

(Is "government practice" restricted to the exercise of government authority, eg exercise of regulatory powers and taxation authority?)

In the dispute of *Korea – Commercial Vessels*, the European Communities alleged that provision of 'loans and loan guarantees' under the Export – Import Bank of Korea (KEXIM) Act constituted direct transfer of funds under Article 1.1(a)(1)(i) of the *SCM Agreement* and hence there was a financial contribution by the government. This was disputed by Korea which argued that KEXIM was operating in a traditional banking capacity and hence performing functions of a bank and not a government.

Korea's argument was rejected by the Panel which held that since the phrase "government practice" in Article 1.1(a)(1)(i) refers to the practice of both governments and public bodies, the practice at issue need not necessarily be purely "governmental" in the narrow sense advocated by Korea (Para 7.28). It further noted that:

> "In our view, the phrase "government practice" in Article 1.1(a)(1)(i) is simply a grammatical construction, or series of words, chosen because sub-paragraph (i) of Article 1.1(a)(1) could not have been drafted in the direct form. As such, it refers to cases ("practice") where governments or public bodies provide direct or potential direct transfers of funds. The phrase "government practice" is therefore used to denote the author of the action, rather than the nature of the action. "Government practice" therefore covers all acts of governments or public bodies, irrespective of whether or not

they involve the exercise of regulatory powers or taxation authority." (Para 7.29)

1.9. Article 1.1 (a) (1) (i) ("direct transfer of funds")
(Does a 'direct transfer of fund' occur only when there is an incremental flow of funds to the recipient that enhances the net worth of the recipient?)

In the dispute of *Japan – DRAMS CVDs (AB)*, Korea argued before the Appellate Body that the Panel was in error for holding that restructuring transactions, in particular the modification of terms of preexisting loans and debt to equity swaps that merely changed the terms of existing claims and did not involve the provision of money to the alleged subsidy recipient were transactions involving a direct transfer of funds.

The Appellate Body while reviewing the Panel's decision held:

> "In our view, the term "funds" encompasses not only "money" but also financial resources and other financial claims more generally. The concept of "transfer of funds" adopted by Korea is too literal and mechanistic because it fails to encapsulate how financial transactions give rise to an alteration of obligations from which an accrual of financial resources results. We are unable to agree that direct transfers of funds, as contemplated in Article 1.1(a)(1)(i), are confined to situations where there is an incremental flow of funds to the recipient that enhances the net worth of the recipient. Therefore, the Panel did not err in finding that the JIA properly characterized the modification of the terms of pre-existing loans in the present case as a direct transfer of funds.
>
> ....Again, we see no error in the Panel's analysis. Debt-to-equity swaps replace debt with equity, and in a case such as this, when the debt-to-equity swap is intended to address the deteriorating financial condition of the recipient company, the cancellation of the debt amounts to a direct transfer of funds to the company." (Paras 250 - 252)

1.10. Article 1.1(a)(1)(i) ("direct transfer of funds")
(At what point in time can a country be considered to grant financial contribution in the form of direct transfer of funds?)

In the dispute of *Brazil Aircraft* an issue before the Panel was at what point in time can Brazil be considered to "grant" PROEX payments in the form of "direct transfers of funds"? The Panel noted that, the verb "grant" has been defined to mean, *inter alia*, "to bestow by formal act" and "give, bestow, confer". It concluded that PROEX payments may be "granted" where the unconditional legal right of the beneficiary to receive the payments has arisen, even if the payments themselves have not yet occurred. (Para 7.71)

1.11. Article 1.1 (a) (1) (i) ("direct transfer of funds (e.g. grants….))"
(Does "grant" include future disbursements?)

In the dispute of *Australia Automotive Leather* the Panel considered the meaning of the word "grant" and stated that "the ordinary meaning of the term "grant" means "the process of granting or a thing granted", and therefore includes both the government's commitment to make payments (that is, the grant contract), and the grant payments themselves, including all possible disbursements, whether past or future." (para 9.39). This meaning of the term "grant" was in the context of payments under grant contracts to the exporter. However similar meaning could be imputed to "grants" in Article 1.1. (a)(1) (i).

1.12. Article 1.1(a)(1)(i) ("potential direct transfer of funds or liabilities") (Does payment *have* to occur for potential direct transfer of funds to exist?)

In the dispute of *Brazil Aircraft*, the Panel observed that:

> ""potential direct transfer of funds" exists only where the action in question gives rise to a benefit and thus confers a subsidy irrespective of whether any payment occurs. In arriving at this view, we have taken contextual guidance from the example of loan guarantees provided in Article 1.1(a)(1) of the SCM Agreement. Whether or not a loan guarantee confers a subsidy does not depend upon whether a payment occurs (i.e., whether the beneficiary of the guarantee defaults and the government is required to make good on the guarantee). For example, Article 14 of the SCM Agreement provides that, when examining benefit to the recipient in a countervail context, "a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that a firm would pay on a comparable commercial loan absent the government guarantee." Thus, whether or not a loan guarantee confers a benefit depends on its effects on the terms of the loan and not on whether there is a default" (Para 7.68)

> "If the category of potential direct transfers of funds referred simply to the situation where a government may in the future make a payment, almost any direct transfer of funds could, at an earlier date, be qualified as a potential direct transfer of funds. Nor do we see any reason to believe that a possible future payment is a "potential direct transfer of funds" merely because of a high probability that a payment will actually occur. The word "potential" has been defined as "possible as opposed to actual" or "capable of coming into being". If the determination whether a measure was a "potential direct transfer of funds" depended upon the degree of likelihood or probability that a payment would subsequently occur, then the drafters surely would have chosen an adjective more suggestive of high probability than "potential."(Para 7.69)

In brief the Panel has clarified that a subsidy exists if a government practice involves a direct transfer of funds or a potential direct transfer of funds and not only when a government actually effectuates such a transfer.

1.13. Article 1.1(a)(1)(ii) ("revenue … otherwise due is foregone") (Can a "but for" legal standard be used as a basis for determining whether revenue due is foregone?)

The Panel found that the term "otherwise due" establishes a "but for" test, in terms of which the appropriate basis of comparison for determining whether revenues are "otherwise due" is "the situation that would prevail but for the measures in question". In the present case, this legal standard provides a sound basis for comparison because it is not difficult to establish in what way the foreign-source income of an FSC would be taxed "but for" the contested measure. However, we have certain abiding reservations about applying any legal standard, such as this "but for" test, in the place of the actual treaty language. Moreover, we would have particular misgivings about using a "but for" test if its application were limited to situations where there actually existed an alternative measure, under which the revenues in question would be taxed, absent the contested measure. It would, we believe, not be difficult to circumvent such a test by designing a tax regime under which there would be no general rule that applied formally to the revenues in question, absent the contested measures. We

observe, therefore, that, although the Panel's "but for" test works in this case, it may not work in other cases." (Para 91)

1.14. Article 1.1(a)(1)(ii) ("otherwise due")
(Object and purpose of otherwise due)

In the dispute *US- FSC Article 21.5* the Appellate Body recalled that:

> ""otherwise due" implies a comparison with a "defined, normative benchmark". The purpose of this comparison is to distinguish between situations where revenue foregone is "otherwise due" and situations where such revenue is not "otherwise due". As Members, in principle, have the sovereign authority to determine their own rules of taxation, the comparison under Article 1.1(a)(1)(ii) of the SCM Agreement must necessarily be between the rules of taxation contained in the contested measure and other rules of taxation of the Member in question. Such a comparison enables Panels and the Appellate Body to reach an objective conclusion, on the basis of the rules of taxation established by a Member, by its own choice, as to whether the contested measure involves the foregoing of revenue that would be due in some other situation or, in the words of the SCM Agreement, "otherwise due"."(Para 89)

1.15. Article 1.1(a)(1)(ii) ("otherwise due is foregone")
(When foregone revenue is otherwise due?)

In the dispute *US- FSC*, the Panel "took the term "otherwise due" to refer to the situation that would prevail but for the measures in question. It is thus a matter of determining whether, absent such measures, there would be a higher tax liability. In our view, this means that a Panel, in considering whether revenue foregone is "otherwise due", must examine the situation that would exist but for the measure in question. Under this approach, the question presented in this dispute is whether, if the FSC scheme did not exist, revenue would be due which is foregone by reason of that scheme."(Para 7.45)

1.16. Article 1.1(a)(1)(ii) ("otherwise due is foregone")
(Can revenue otherwise due be foregone as a result of tax treatment at sub federal level?)

In the dispute *US- FSC* the Panel has clarified that "the determination whether revenue foregone is "otherwise due" must involve a comparison between the fiscal treatment being provided by a Member in a particular situation and the tax regime otherwise applied by that Member (or, in the case of tax treatment at a sub-Member level, the tax regime otherwise applied by the taxing authority in question)."(Para 7.43)

1.17. Article 1.1(a)(1)(ii) – ("revenue … otherwise due is foregone")
(Should the comparator for determining revenue otherwise due be something other than the domestic rules of taxation?)

In the dispute *US- FSC* an issue before the Appellate Body was what should be the comparator for determining revenue otherwise due is foregone. The US argued that the comparator in determining what "otherwise due" is should be something other than the prevailing domestic standard of the Member in question. While disagreeing with the US the Appellate Body was of the view that:

> "The "foregoing" of revenue "otherwise due" implies that less revenue has been raised

by the government than would have been raised in a different situation, or, that is, "otherwise". Moreover, the word "foregone" suggests that the government has given up an entitlement to raise revenue that it could "otherwise" have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax all revenues. There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised "otherwise". We, therefore, agree with the Panel that the term "otherwise due" implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation. We also agree with the Panel that the basis of comparison must be the tax rules applied by the Member in question. To accept the argument of the United States that the comparator in determining what is "otherwise due" should be something other than the prevailing domestic standard of the Member in question would be to imply that WTO obligations somehow compel Members to choose a particular kind of tax system; this is not so. A Member, in principle, has the sovereign authority to tax any particular categories of revenue it wishes. It is also free not to tax any particular categories of revenues. But, in both instances, the Member must respect its WTO obligations. What is "otherwise due", therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself. (Para 90)

1.18. Article 1.1(a)(1)(ii) – and footnote 59 ("otherwise due") (Does footnote 59 qualify "otherwise due"?)

In the dispute *US- FSC* before the Appellate Body US argued that the Panel erred because the general interpretation of the term "otherwise due" "must yield" to the standard the United States perceives in footnote 59 of the *SCM Agreement*, which the United States contends, is the "controlling legal provision" for interpretation of the term "otherwise due" with respect to a measure of the kind at issue. In the view of the United States, footnote 59 means that the FSC measure is not a "subsidy" under Article 1.1 of the *SCM Agreement*. Thus, the United States does not read footnote 59 as providing context for the general interpretation of the term "otherwise due"; rather, the United States views footnote 59 as a form of exception to that general interpretation. (Para 92)

The Appellate Body disagreed with the argument of US and held that:

"Article 1.1 sets forth the general definition of the term "subsidy" which applies "for the purpose of this Agreement". This definition, therefore, applies wherever the word "subsidy" occurs throughout the *SCM Agreement* and conditions the application of the provisions of that Agreement regarding prohibited subsidies in Part II, actionable subsidies in Part III, non-actionable subsidies in Part IV and countervailing measures in Part V." (Para 93)

"By contrast, footnote 59 relates to one item in the Illustrative List of Export Subsidies. Even if footnote 59 means – as the United States also argues – that a measure, such as the FSC measure, is not a prohibited export subsidy, footnote 59 does not purport to establish an exception to the general definition of a "subsidy" otherwise applicable throughout the entire SCM Agreement. Under footnote 5 of the SCM Agreement, where the Illustrative List indicates that a measure is not a prohibited export subsidy, that measure is not deemed, for that reason alone, not to be a "subsidy". Rather, the measure is simply not prohibited under the Agreement. Other provisions of the SCM Agreement may, however, still apply to such a "subsidy"." (Para 93)

"In light of the above, we do not accept the United States' argument that footnote 59 qualifies the general interpretation of the term "otherwise due"." (Para 94)

1.19. Article 1.1(a)(1)(ii) ("revenue…otherwise due is forgone")
(What is the relevant comparison for determining whether revenue otherwise due is foregone?)

In the dispute *US- FSC Article 21.5* an issue before the Panel was when is revenue otherwise due foregone. A related issue was what should be the comparative benchmark for determining revenue otherwise due is foregone. The Appellate Body was of the view that "the comparison to be made involves revenues due under the contested measure and those that would be due in some other situation and that the basis of the comparison must be the tax rules applied by the Member in question." The compliance Panel was of the view that:

"While the inquiry cannot be inherently presumptive or speculative, neither can it be so exacting or confining that it is necessary to attain the level of establishing a mathematical deductive relationship between the contested measure and the default situation. To interpret the SCM Agreement in the latter manner would expose a Panel to precisely the manifestly absurd consequence referred to …. above. The key point is that the tax rules applied by the Member in question are the basis for the comparison. Thus, any finding that revenue has been foregone must be securely grounded on that foundation."(Para 8.18)

"Our task is to assess whether, in essence, this "exclusion" of "extraterritorial income" can properly be characterized as a situation in which no revenue is inherently due, or whether it is a situation in which revenue otherwise due is foregone. In doing so, we look at the overall situation as an integrated whole."(Para 8.23)

The compliance Panel also determined that there was a prevailing domestic standard against which the disputed measures were compared for ascertaining effective departures from such standard.

1.20. Article 1.1(a)(1)(ii) ("revenue…otherwise due is forgone")
(What are the considerations for determining exceptions to prevailing domestic standards?)

In the dispute *US- FSC Article 21.5* the compliance Panel was of the view that "the terms of the *SCM Agreement* are clear enough, their application to the facts of the multiplicity of Members' regimes will not necessarily be self-evident. Indeed, discerning what might be described as "the prevailing domestic standard" for a particular tax regime may be a particularly exacting exercise. In more common usage, it might be rather difficult to discern what is the exception, as it were, and what is the rule. But the terms of the *SCM Agreement* are clearly of general application: there is nothing which states that they are only to be applied when the results are self-evident." Compliance Panel had weighed such considerations as "the degree of conditionality, the range of limitations and the manner in which the measure at issue relates to the overall regime. Taken together, they enable us to assess the nature of the relationship of the measure at issue and the overall regime. That is precisely how one is in a position to arrive at the judgment required by the terms of the *SCM Agreement*."(Para 8.29)

1.21. Article 1.1(a)(1) (ii) ("otherwise due")
(Responsibility of Panels identifying appropriate benchmark for "otherwise due"

standard)

In the dispute *US- FSC Article 21.5* the Appellate Body has suggested which benchmark for "otherwise due" due standard should be used by Panels. In the Appellate Body's view:

> **"**In identifying the appropriate benchmark for comparison, Panels must obviously ensure that they identify and examine fiscal situations which it is legitimate to compare. In other words, there must be a rational basis for comparing the fiscal treatment of the income subject to the contested measure and the fiscal treatment of certain other income. In general terms, in this comparison, like will be compared with like. For instance, if the measure at issue involves income earned in sales transactions, it might not be appropriate to compare the treatment of this income with employment income." (Para 90)
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> "In identifying the normative benchmark, there may be situations where the measure at issue might be described as an "exception" to a "general" rule of taxation. In such situations, it may be possible to apply a "but for" test to examine the fiscal treatment of income absent the contested measure. We do not, however, consider that Article 1.1(a)(1)(ii) always requires Panels to identify, with respect to any particular income, the "general" rule of taxation prevailing in a Member. Given the variety and complexity of domestic tax systems, it will usually be very difficult to isolate a "general" rule of taxation and "exceptions" to that "general" rule. Instead, we believe that Panels should seek to compare the fiscal treatment of legitimately comparable income to determine whether the contested measure involves the foregoing of revenue which is "otherwise due", in relation to the income in question." (Para 91)
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> "In addition, it is important to ensure that the examination under Article 1.1(a)(1)(ii) involves a comparison of the fiscal treatment of the relevant income for taxpayers in comparable situations. For instance, if the measure at issue is concerned with the taxation of foreign-source income in the hands of a domestic corporation, it might not be appropriate to compare the measure with the fiscal treatment of such income in the hands of a foreign corporation." (Para 92)

1.22. <u>Article 1.1(a)(1) (ii)</u> ("revenue… otherwise due is foregone")
(Does a financial contribution arise if a government does not raise revenue, which it could have raised?)

In the dispute *US- FSC Article 21.5* the Appellate Body reiterated that:

> "The first is that, under Article 1.1(a)(1)(ii), a "financial contribution" does not arise simply because a government does not raise revenue which it could have raised. It is true that, from a fiscal perspective, where a government chooses not to tax certain income, no revenue is "due" on that income. However, although a government might, in a sense, be said to "forego" revenue in this situation, this alone gives no indication as to whether the revenue foregone was "otherwise due". In other words, the mere fact that revenues are not "due" from a fiscal perspective does not determine that the revenues are or are not "otherwise due" within the meaning of Article 1.1(a)(1)(ii) of the SCM Agreement."(Para 88)

1.23. <u>Article 1.1(a)(1)(ii)</u> ("revenue…otherwise due is forgone")
(Is revenue otherwise due foregone if in a country's legislation gross income does not include income generated from export activities?)

In the dispute *US- FSC Article 21.5*, US was of the view that "there would not be revenue foregone that was "otherwise due" within the meaning of Article 1.1 of the *SCM Agreement* if the US legislation provided that "gross income does not include income generated from export activities". "The ordinary meaning of the terms of Article 1.1(a)(ii) suggests that in such a situation there would not be a financial contribution within the meaning of Article 1.1(a)(1), as the "tax revenue on export activities would not be "otherwise due" under the law of the Member, which is the normative benchmark for an Article 1 analysis".

The Panel was of the view that:

> "Taken to its logical extreme, this US argument would be that a government could opt to bestow financial contributions in the form of fiscal incentives simply by modulating the "outer boundary" of its "tax jurisdiction" or by manipulating the definition of the tax base to accommodate any "exclusion" or "exemption" or "exception" it desired, so that there could never be a foregoing of revenue "otherwise due". This would have the effect of reducing paragraph (ii) of Article 1.1(a)(1) of the SCM Agreement to "redundancy and inutility" and cannot be the appropriate implication to draw from the stipulation as to what constitutes one of the enumerated forms of "financial contribution" under Article 1.1 of the SCM Agreement. Furthermore, the consequences of this reasoning would also entirely undermine Article 3.1(a) of the SCM Agreement, as there could never be, in this situation, a subsidy contingent upon export in the form of a financial contribution involving of a foregoing of revenue that is otherwise due. As such, it is inherently contradictory to what may be viewed as the object and purpose of the SCM Agreement in terms of disciplining trade-distorting subsidies in a way that provides legally binding security of expectations to Members. In this regard, it is evident that the interpretation advanced by the United States would be irreconcilable with that object and purpose, given that it would offer governments "carte-blanche" to evade any effective disciplines, thereby creating fundamental uncertainty and unpredictability. In short, such an approach would eviscerate the subsidies disciplines in the SCM Agreement."(Para 8.39)

1.24. <u>Article 1.1(a)(i)(ii)</u> ("revenue…otherwise due is forgone")
(Is it necessary that a members legislation involves exclusively subsidies that are export dependent to make a finding of prohibited export subsidies?)

In the dispute *US- FSC Article 21.5* an issue before the compliance Panel was whether it is "necessary to show that all subsidies under the Act are export-dependent. And that a subsidy that is export-contingent in some situation does not cease to be so if it can also be obtained in other situation which do not require export." The compliance Panel did not believe that:

> "It is necessary that the Act involves exclusively subsidies that are export-dependent in order to make a finding that the Act involves a defined segment of subsidies – i.e. in respect of US-produced goods -- that are prohibited export subsidies because, in respect of this defined segment, the Act is inevitably and invariably conditioned on exportation. The fact that the Act also involves subsidies with respect to goods produced outside the United States -- that need not be exported from the United States by reason of the foreign use requirement alone in order to qualify for the subsidy -- does not, in our view, vitiate the export-contingency of the Act that we find in respect of US-produced goods."(Para 8.64)

1.25. <u>Article 1.1(a)(1)(ii)</u> ("revenue … otherwise due is foregone")
(Is revenue foregone if a member chooses not to tax foreign source income?)

In the dispute *US FSC* before the Appellate Body the United States' took the position that Members of the WTO are not obliged to tax foreign-source income, and also that Members may tax such income less than they tax domestic-source income. The United States argued that, since there is no requirement to tax export-related foreign-source income, a government cannot be said to have "foregone" revenue if it elects not to tax that income.

The Appellate Body was of the view that, "even in the absence of footnote 59, Members of the WTO are not obliged, by WTO rules, to tax any categories of income, whether foreign- or domestic-source income." It seemed to the Appellate Body that, "taken to its logical conclusion, this argument by the United States would mean that there could never be a foregoing of revenue "otherwise due" because, in principle, under WTO law generally, no revenues are ever due and no revenue would, in this view, ever be "foregone". That cannot be the appropriate implication to draw from the requirement to use the arm's length principle." (Para 98)

1.26. <u>Article 1.1(a) (1)(ii)</u> ("revenue…… otherwise due is foregone")
(Is import duty exemption to certain importers a financial contribution)

In the dispute *Canada – Certain Measures Affecting the Automotive Industry* an issue before the Panel was whether import duty exemption to certain importers constituted revenue otherwise due is foregone. The Panel recalled that:

> "The import duty exemption is accorded to particular importers and not to others, and further consider that, in the absence of the import duty exemption, imports by manufacturer beneficiaries which are shielded from duties by that exemption would be subject to duties. Accordingly, absent the import duty exemption accorded to certain companies under the MVTO 1998 and the SROs, those companies would be liable to pay duties of up to 6.1 per cent on the motor vehicles in question."(Para 10.160)

The Panel found that "The import duty exemption constitutes the "foregoing" of government revenue which is "otherwise due". (Para 10.160)

1.27. <u>Article 1.1(a)(1)(ii)</u> ("revenue…..foregone")
(If import duty exemption is revenue foregone then does a subsidy exist if the import duty is less than the bound rate?)

In the dispute *Canada – Certain Measures Affecting the Automotive Industry* before the Panel Canada argued that "If an import duty exemption were necessarily treated as revenue foregone, a subsidy would exist every time a WTO Member applied a rate lower than its bound rate, and this would be contrary to the object and purpose of the WTO Agreement, which explicitly identifies tariff reductions as contributing to the objectives of the Agreement."

It was the view of the Panel that "A Member's bound rate merely represents the maximum duty a Member may impose in respect of imports from WTO Members; the mere fact that a WTO Member applies a level of duties lower than the bound rate would not mean that it is foregoing revenue that is "otherwise due. (Para 10.161)

1.28. <u>Article 1.1(a)(1)(ii)</u> ("revenue…..foregone")
(Does foregoing of revenue otherwise due in the form of customs duties, necessarily give rise to a subsidy?)

In the dispute *Canada – Certain Measures Affecting the Automotive Industry* the Panel considered that "the foregoing of government revenue otherwise due, in the form of customs duties, and in a manner which is specific within the meaning of Article 2, may give rise to a subsidy which is subject to the disciplines of the SCM Agreement"(Para 10.161). The implication of this appears to be that if the import due exemption is available in a non-specific manner it may not constitute a subsidy.

1.29. Article 1.1(a)(1)(ii) ("revenue…..foregone")
(Does subsidy exist every time GSP preferences or duty drawback are granted?)

In the dispute *Canada – Certain Measures Affecting the Automotive Industry*, Canada argued that "if an import duty exemption were necessarily treated as revenue foregone, a subsidy would exist every time generalised preferences or duty drawbacks were granted by a WTO Member." While disagreeing with Canada the Panel was of the view that "a generalised system of preferences accords favourable treatment to certain products from certain countries, and all such products from those countries receive favourable treatment. That situation is distinct from the case at hand, where some importers of a product – the manufacturer beneficiaries – are accorded favourable treatment as compared with other importers of the same product from the same country." (Para 10.162)

In respect of duty drawback the Panel was of the view that "item (i) of the Illustrative List indicates the circumstances in which the remission or drawback of import charges on imported inputs consumed in the production of the exported product constitutes an export subsidy. When read in conjunction with footnote 1 to the *SCM Agreement*, item (i) would appear to indicate – although this is not an issue we need decide in this dispute – that non-excessive duty drawback is not to be considered a subsidy within the meaning of Article 1 of the Agreement."(Para 10.162)

1.30. Article 1.1(a)(1)(ii) ("revenue … otherwise due is foregone")
(Is a member free not to tax any income, even if it is a subsidy?)

In the dispute *US- FSC Article 21.5*, the Appellate Body was of the view that:

> "Article 1.1 of the SCM Agreement does not prohibit a Member from foregoing revenue that is otherwise due under its rules of taxation, even if this also confers a benefit under Article 1.1(b) of the SCM Agreement. However, if a Member's rules of taxation constitute or provide a subsidy under Article 1.1, and this subsidy is specific under Article 2, the Member must abide by the obligations set out in the SCM Agreement with respect to that subsidy, including the obligation not to "grant [] or maintain" any subsidy that is prohibited under Article 3 of the Agreement. It was in this context that we said in our Report in US – FSC, that, in principle, a Member is free not to tax any particular category of income it wishes, even if this results in the grant of a "subsidy" under Article 1.1 of the SCM Agreement, provided that the Member respects its WTO obligations with respect to the subsidy." (Para 86)

1.31. Footnote 1
(Is remission of imports charges covered by Footnote 1?)

In the dispute *Canada – Certain Measures Affecting the Automotive Industry*, the Panel has clarified that non-excessive remission or drawback of import charges does not constitute an export subsidy. According to the Panel "item (i) of the Illustrative List indicates the circumstances in which the remission or drawback of import charges on imported inputs

consumed in the production of the exported product constitutes an export subsidy. When read in conjunction with footnote 1 to the *SCM Agreement*, item (i) would appear to indicate – although this is not an issue we need decide in this dispute – that non-excessive duty drawback is not to be considered a subsidy within the meaning of Article 1 of the Agreement."(Para 10.162)

1.32. Footnote 1
(Applicability restricted to duty and tax exemptions or remissions for exported remission on exported products)

In the dispute *Canada – Certain Measures affecting the Automotive Industry (AB)* the Appellate Body has clarified that:

> "Footnote 1 to the SCM Agreement deals with duty and tax exemptions or remissions for exported products. The measure at issue applies, in contrast, to imports of motor vehicles which are sold for consumption in Canada. For this reason, we do not consider that footnote 1 bears upon the import duty exemption at issue in this case."(Para 92)

1.33. Footnote 1
(Applicability restricted to taxation on products and does not include taxation of corporations)

In the dispute *US FSC* the Appellate Body held that "The tax measures identified in footnote 1 as not constituting a "subsidy" involve the exemption of exported products from product-based consumption taxes. The tax exemption under the FSC measure relate to the taxation of corporations and not products. Footnote 1 does not cover measures such as the FSC measure." (Para 93)

1.34. Article 1.1 (a)(1)(iii) ("goods")
(Can "standing timber" be classified as a "good"?)

In the dispute of *Softwood Lumber IV (AB),* Canada argued that the term "goods" was limited to tradable items with an actual or potential tariff classification, such that standing timber did not fall within its definition. Examining dictionary definitions of the term "goods," the Appellate Body agreed with the Panel that the ordinary meaning of the term as used in Article 1.1(a)(1)(iii) includes items that are tangible and capable of being possessed." Nonetheless, the Appellate Body also noted that dictionary definitions have their limitations in revealing the ordinary meaning of a term, especially where the meanings of terms used in the different authentic texts of the WTO Agreement are susceptible to differences in scope. Here, for example, the terms used in the French and Spanish texts "include a wide range of property, including immovable property," In addition, the Appellate Body found unconvincing Canada's assertion that "standing timber" does not meet the definition of "goods" because it is neither a "personal property" nor an "identified thing to be severed from real property." In this regard, the Appellate Body noted that the concepts of "personal" and "real" property are "creatures of municipal law that are not reflected in Article 1.1(a)(1)(iii) itself," and that "the manner in which the municipal law of a WTO Member classifies an item cannot, in itself, be determinative of the interpretation of provisions of the WTO covered agreements. (Paras 57 - 65)

The Appellate Body summarized its findings as follows:

> "In sum, nothing in the text of Article 1.1(a)(1)(iii), its context, or the object and purpose of the SCM Agreement, leads us to the view that tangible items -- such as standing, unfelled trees -- that are not both tradable as such and subject to tariff classification, should be excluded, as Canada suggests, from the coverage of the term 'goods' as it appears in that Article." Thus, the Appellate Body concluded that it agreed with the Panel "that standing timber – trees - are 'goods' within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement." (Para. 67)

1.35. <u>Article 1.1 (a)(1)(iii)</u> ("provides" goods or services)
(Does the term "provides" means to "make available"?)

In the dispute of *Softwood Lumber IV (AB)*, Canada argued before the Appellate Body that stumpage arrangements did not 'provide' standing timber because these arrangements provided only an intangible right to harvest, which at best merely made available standing timber. Canada suggested that the terms "provides goods" and "provides services" could not be read to include the mere "making available" of goods or services, because "[t]o 'make available services' … would include any circumstance in which a government action makes possible a later receipt of services and to 'make available goods' would capture every property law in a jurisdiction". (Paras 69 - 70)

In contrast, the United States argued that the Panel's interpretation that stumpage arrangements "provide" standing timber was correct. The United States contended that, where a government transferred ownership in goods by giving enterprises a right to take them, the government "provides" those goods, within the meaning of Article 1.1(a)(1)(iii). The Appellate Body noted:

> "…we do not see how the general governmental acts referred to by Canada would necessarily fall within the concept of a government "making available" services or goods. In our view, such actions would be too remote from the concept of "making available" or "putting at the disposal of", which requires there to be a reasonably proximate relationship between the action of the government providing the good or service on the one hand, and the use or enjoyment of the good or service by the recipient on the other. Indeed, a government must have some control over the availability of a specific thing being "made available"" (Para 71)

Additionally, the Appellate Body rejected Canada's argument referring to the use of the term "provide(s)" in GATS Article XV:1 and Agriculture Agreement Articles 3.2 and 8, which, Canada asserted, suggest that "provides," when used in the subsidy context, requires the actual "giving" of a subsidy. In this regard, the Appellate Body stated, that the different context of these provisions meant that it was not necessarily appropriate to equate, precisely, the scope of the term 'provide' or 'provides' as they were used in these different agreements. Thus, it said that even if it accepted Canada's arguments as to the narrow scope of the term in those other provisions, it would not necessarily imply that such a narrow scope should be given to the term as used in *SCM Agreement* Article 1.1(a)(1)(iii). (Paras 70 - 74)

1.36. <u>Article 1.1(a)(1)(iv)</u> ("entrusts or directs a private body")
(Whether the act of entrustment and direction is restricted to the notion of delegation and command respectively?)

In the dispute of *US – DRAMS CVD Investigation (AB)*, both US and Korea had appealed specific aspects of the Panel's interpretation of this provision. The Panel had stated that it

agreed with the *US-Export Restraints* Panel that ordinary meanings of the two words 'entrusts' and 'directs' must contain a notion of delegation and command respectively. The Appellate Body noted that in doing the above, the Panel had effectively replaced the terms 'entrusts' and 'directs' with two other terms – delegation and command, whose scope it did not define and went no further in clarifying the meanings of these terms. Further, the Appellate Body also noted that such an interpretation was too narrow considering the language of Article 1.1. (Paras 108 -111)

Summarizing, the Appellate Body held that

> "..we are of the view that, pursuant to paragraph (iv), "entrustment" occurs where a government gives responsibility to a private body, and "direction" refers to situations where the government exercises its authority over a private body. In both instances, the government uses a private body as proxy to effectuate one of the types of financial contributions listed in paragraphs (i) through (iii). It may be difficult to identify precisely, in the abstract, the types of government actions that constitute entrustment or direction and those that do not. The particular label used to describe the governmental action is not necessarily dispositive. Indeed, as Korea acknowledges, in some circumstances, "guidance" by a government can constitute direction. In most cases, one would expect entrustment or direction of a private body to involve some form of threat or inducement, which could, in turn, serve as evidence of entrustment or direction. The determination of entrustment or direction will hinge on the particular facts of the case." (Para 116)

1.37. <u>Article 1.1(a)(1)(iv)</u> ("entrusts or directs a private body")
(Whether the act of entrusting or directing a private body should be an explicit and affirmative government action addressed to the particular entity?)

In the dispute of *Korea – Commercial Vessels*, the European Communities argued that a number of private financial institutions involved as creditors in debt restructuring of shipbuilders were subjected to a high level of influence and they were hence entrusted or directed by the Korean Government as per Article 1.1(a)(1)(iv). Korea argued that express proof was required to demonstrate such entrustment or direction.

The Panel partially based its reasoning on the *US-Export Restraints* which had stated that the action of the government must contain a notion of delegation, in case of entrustment and a notion of command, in case of direction (*This interpretation has been modified by the Appellate Body in the US – DRAMS CVD Investigation. Refer 1.7 above*). The *US-Export Restraints* Panel had however also stated both the act of entrusting and directing necessarily carry with them an element of explicit and affirmative action addressed to a particular party, where the object of which is action of a particular task or duty. The *Korea – Commercial* Panel, in contrast held that nothing in the text of Article 1.1(a)(1)(iv) supports a conclusion that the act of delegation or command must be explicit. According to the Panel, such an act could be explicit or implicit, formal or informal. However, the evidence of entrustment or direction must in all cases be probative and compelling, which was not provided by the European Communities in the present case. (Paras 7.367- 7.407)

Similar reasoning was also followed by the Panel in the *US – DRAMS CVD Investigation.* (Paras 7.30 – 7.42) and *EC – DRAMS Countervailing Measures* (Paras 7.53 – 7.57).

In the dispute of *US – DRAMS CVD Investigation (AB)*, the Appellate Body noted that a demonstrable link must be established between the government and the conduct of the private body. It found confirmation for its interpretation in the object and purpose of the

SCM Agreement and stated that:

> "…Article 1.1(a)(1)(iv) is, in essence, an anti-circumvention provision. A finding of entrustment or direction, therefore, requires that the government give responsibility to a private body—or exercise its authority over a private body—in order to effectuate a financial contribution.
>
> It follows, therefore, that not all government acts necessarily amount to entrustment or direction. We note that both the United States and Korea agree that "mere policy pronouncements" by a government would not, by themselves, constitute entrustment or direction for purposes of Article 1.1(a)(1)(iv). Furthermore, entrustment and direction—through the giving of responsibility to or exercise of authority over a private body—imply a more active role than mere acts of encouragement. Additionally, we agree with the Panel in *US – Export Restraints* that entrustment and direction do not cover "the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market." (Paras 112-115)

1.38. <u>Article 1.1(a)(1)(iv)</u> ("entrusts or directs a private body")
(Whether a finding of entrustment or direction under Article 1.1 (a)(1)(iv) requires that a private body carry out one of the functions listed in that provision?)

In the dispute of *US – DRAMS CVD Investigation (AB)*, Korea argued that a finding of entrustment or direction required that a private body carry out one of the functions listed in Article 1.1 (a)(1) and that the Korea First Bank (KFB) did not carry out the action it was allegedly entrusted or directed to carry out. Therefore, the Panel's finding of entrustment or direction in respect of KFB was incorrect.

The Appellate Body upheld the Panel's finding of entrustment or direction in respect of KFB. The Panel had earlier ruled that evidence was sufficient for an objective and impartial investigating authority to properly find government entrustment or direction in respect of KFB. The Appellate Body further clarified that:

> "In any event, a finding of entrustment or direction, by itself, does not establish the existence of a financial contribution. Where a government entrusts or directs a private body—by giving responsibility to or exercising its authority over the private body—it is likely that the function that is allegedly entrusted or directed will indeed be carried out. The private body's refusal to carry out the function may be evidence that the government did not give it responsibility for such function, or that the government did not exercise the requisite authority over it such that the private body did not heed the government. It does not, however, on its own, mean that the private body was not entrusted or directed. Depending on the circumstances, a private body may decide not to carry out a function with which it was so entrusted or directed, despite the possible negative consequences that may follow.
>
> …Failure by the private body to carry out one of the functions of the types listed in paragraphs (i) through (iii) means that nothing of economic value has been transferred from the grantor to the recipient. Simply put, if the private body has not carried out the function allegedly entrusted or directed to it, nothing will have changed hands. Therefore, there is no financial contribution and, consequently, there would be no right to apply countervailing measures. " (Paras 124 - 125)

1.39. <u>Article 1.1(a)(1)(iv)</u> ("entrusts or directs a private body")
(What is the evidentiary standard required for establishing entrustment or direction?)

The Panels in the disputes of *Korea – Commercial Vessels*, *EC – DRAMS Countervailing Measures* and *US – DRAMS CVD Investigation* ruled that the evidence of entrustment or direction must in all cases be "probative and compelling".

In *US – DRAMS CVD Investigation (AB)*, the US claimed that the Panel erred in applying an evidentiary standard that required evidence to be both probative and compelling. While the US agreed that that evidence is 'probative' by its very nature, the standard of 'compelling' evidence refers to evidence of such weight as to require the decision maker to arrive at one given decision. The Appellate Body noted that nothing in the *SCM Agreement* or the DSU imposes upon an investigating authority a particular standard for the evidence supporting its entrustment or direction finding. The Appellate Body concluded that the Panel did not apply the term "compelling" in the manner suggested by the United States; had it done so, it would have erroneously imposed a qualitative standard higher than that contemplated by the *SCM Agreement*. The Panel had not required the evidence to be 'irrefutable' or the evidence to be of such quality or quantity so as to 'force' a finding of entrustment or direction; rather it looked into whether the evidence could support a conclusion of entrustment or direction. (Paras 138 - 140)

1.40. <u>Article 1.1(a)(1)(iv)</u> ("entrusts or directs a private body")
(Should uncooperative behavior of the interested parties be taken into account by the investigating authority while weighing evidence of entrustment or direction?)

In the dispute of *EC – DRAMS Countervailing Measures*, the Panel noted that the extent to which the interested parties cooperated with the authority is also a relevant element to be taken into account. The Panel stated:

> "In those cases where certain essential information which was clearly requested by the investigating authority is not provided, we consider that this uncooperative behavior may be taken into account by the authority when weighing the evidence and the facts before it. The fact that certain information was withheld from the authority may be the element that tilts the balance in a certain direction. Depending on the circumstances of the cases, we consider that an authority may be justified in drawing certain inferences, which may be adverse, from the failure to cooperate with the investigating authority. We consider relevant, in this respect, the following statement of the Appellate Body in the *US – Hot-Rolled Steel* case concerning the facts available provision of Article 6.8 of the *AD Agreement*, which is very similar both textually and contextually to Article 12.7 of the *SCM Agreement*:
>
> > "[i]n order to complete their investigations, investigating authorities are entitled to expect a very significant degree of effort – to the "best of their abilities" – from investigated exporters. At the same time, however, the investigating authorities are not entitled to insist upon *absolute* standards or impose *unreasonable* burdens upon those exporters". (emphasis in original).
>
> …we acknowledge that this statement was, at least in part, based on several paragraphs of Annex II to the *AD Agreement*, we consider that a similar significant degree of cooperation is to be expected of interested parties in a countervailing duty investigation. "(Paras 7.60 – 7.61)

1.41. Article 1.1(a)(1)(iv) ("entrusts or directs a private body")
(Whether presence of government officials in meetings of a private body indicates government entrustment or direction?)

In the dispute of *EC – DRAMS Countervailing Measures*, the European Communities had concluded that creditor banks that participated in the restructuring programme of Hynix Semiconductor, (the alleged recepient of subsidy from the Korean government) were directed by the government to buy bonds and thus purchase hence constituted a financial contribution. Importantly, the European Communities alleged that presence of Financial Supervisory Service (FSS) and Financial Supervisory Commission (FSS) officials in one of the creditors' council meeting was withheld from the EC authorities in spite of explicit requests to make known any government involvement in the restructuring and any government participation in the meeting of the creditor banks.

In its examination, the Panel noted that while government officials' presence may show the interest the government took in the survival of Hynix Semiconductor, this is not sufficient to conclude that the government delegated this task of rescuing Hynix Semiconductor to private banks or ordered them to do so. Further, presence of an important FSC/FSS official meeting is certainly 'relevant' but is not determinative of government 'entrustment or direction'. (Paras 7.97 – 7.100)

The Panel stated:

> "…it is, in our view, insufficient as a basis for the conclusion that this government interest went beyond that and that the government was actually entrusting or directing the private creditors to invest in Hynix.
>
> As we explained earlier, the terms "entrust or direct" refer to the government using the private bodies as the instrument through which the government is providing a financial contribution, either by giving the private body a command or by delegating a task to the private body which involves a financial contribution. We consider that the maximum one can conclude from this high ranking government official's presence is that the private bodies may have felt that the government was interested in seeing the creditor banks reach agreement to rescue Hynix, and that the government would also be doing what it could to achieve that goal by acting through its public bodies for example. This, however, is not the same as the government *entrusting or directing* the banks to accept the terms of the May 2001 Restructuring Programme." (Para 7.101 -7. 102)

1.42. Article 1.1(a)(1)(iv) ("entrusts or directs a private body")
(What is the role of press reports while evaluating evidence of entrustment or direction?)

In the dispute of *EC – DRAMS Countervailing Measures*, the Panel while evaluating the reliance on press reports by the European Communities to establish a case of government entrustment or direction noted that:

> "The press reports thus revealed a set of facts which was later confirmed by the parties, and their value as a source of information is thus not an issue. We are of the view that a distinction should be made between the facts described in the press reports and the journalistic colouring of these facts. While we do not reject press reports as a source of evidence, we are of the view that the investigating authority should be very careful about attaching too much weight to unverified statements in press reports. The

characterisation of the events by the press reports, without supporting evidence, is in other words not particularly probative in a trade remedy investigation. " (Para 7.98)

1.43. <u>Article 1.1(a)(1)(iv)</u> ("entrusts or directs a private body")
(Is a finding of commercial reasonableness indispensable to the finding of entrustment or direction?)

In the dispute of *Japan – DRAMS CVDs (AB)*, Japan contended that the Panel had erred in its interpretation of entrustment or direction as it had limited its review of the 2002 restructuring of Hynix Semiconductors to the restructuring plan prepared by the Deutsche Bank (DB Report) without considering, as was done by the Japan Investigating Authorities (JIA), whether the evidence in its totality supported a finding of entrustment or direction.

The Appellate Body said it disagreed with the Panel's approach. In particular, the Appellate Body noted that the JIA came to its finding on entrustment or direction based upon a consideration of the totality of evidence before it and made a holistic assessment of the evidence before it. Further, it was not evident that the JIA accorded such decisive weight to the issue of commercial reasonableness as to render insignificant other evidence relating to the Korean government's intent to save Hynix and its intervention in the restructuring process. (Para 133)

The Appellate Body noted:

> "Thus, it seems to us that the sole basis on which the Panel came to different conclusions on entrustment or direction in the two Restructurings was its findings on the commercial reasonableness of the Four Creditors' participation in those Restructurings.
>
> The Panel did not adequately explain why a finding of commercial reasonableness, by itself, was indispensable for the ultimate finding of entrustment or direction. We are unable to discern from the JIA's determination that the JIA considered commercial reasonableness to be indispensable for its ultimate finding of entrustment or direction. Even if the Panel were correct that the JIA's finding on commercial unreasonableness lacked evidentiary support that alone would not necessarily invalidate the JIA's determination of entrustment or direction. As we have stated above, the Panel should have considered whether, in the light of the remaining evidence, the JIA could nevertheless have reached its finding on entrustment or direction.
>
> We recognize that the commercial unreasonableness of the financial transactions is a relevant factor in determining government entrustment or direction under Article 1.1(a)(1)(iv) of the SCM Agreement, particularly where an investigating authority seeks to establish government intervention based on circumstantial evidence. However, this does not mean that a finding of entrustment or direction can never be made unless it is established that the financial transactions were on noncommercial terms. A finding that creditors acted on the basis of commercial reasonableness, while relevant, is not conclusive of the issue of entrustment or direction." (Paras 136 -138)

1.44. <u>Article 1.1(a)(1)(iv)</u> ("a government makes payment to a funding mechanism or … entrusts or directs")
(Are "a government makes payment to a funding mechanism or … entrusts or directs" equivalent actions?)

In the dispute *US - Exports Restraints*, the Panel noted that the phrase "entrusts or directs" in Article 1.1(a)(1)(iv) is immediately preceded by the phrase "a government makes payments to a funding mechanism or" and considered that:

> "these two phrases are aimed at capturing equivalent government actions. Both are government actions that substitute an intermediary (whether a funding mechanism or a private body) to make a financial contribution that otherwise would be made directly by the government. In other words, the action of a government making payments to a funding mechanism and that of it entrusting or directing a private body to carry out the functions listed in subparagraphs (i)-(iii) are equivalent government actions. This is further contextual support for our view that entrustment or direction constitutes an explicit and affirmative action, comparable to the making of payments to a funding mechanism". (Para 8.31)

1.45. <u>Article 1.1(a)(1)(iv)</u> ("a government entrusts or directs")
(When can entrustment or direction be said to have occurred?)

In the dispute *US - Exports Restraints* the issue before the Panel was whether an export restraint would constitute a financial contribution in the form of Government entrusted or Government directed provision of goods in the sense of Article 1.1(a)(1)(iii) and (iv). The US argued before the Panel that if the export restraint results in the producers having no practical or commercial choice but to sell or to increase its sales in the domestic market the restraint was the same as a direction to sell in the domestic market. The US argued that there is a proximate causal relationship between the export restraints or the behaviour of the producers of the restrained product. The US also saw no substantive difference between a restriction of exporting a product and an instruction to sell that product domestically.

The Panel was of the view that "the requirement of "entrustment" or "direction" in subparagraph (iv) refers to the situation in which the government executes a particular policy by operating through a private body" (para 8.28). The Panel identified three elements which, in its view, are required to be present for entrustment or direction to be said to have occurred. According to the Panel:

> **"**both the act of entrusting and that of directing therefore necessarily carry with them the following three elements: (i) an explicit and affirmative action, be it delegation or command; (ii) addressed to a particular party; and (iii) the object of which action is a particular task or duty. In other words, the ordinary meanings of the verbs "entrust" and "direct" comprise these elements – something is necessarily delegated, and it is necessarily delegated to someone; and, by the same token, someone is necessarily commanded, and he is necessarily commanded to do something. We therefore do not believe that either entrustment or direction could be said to have occurred until all of these three elements are present." (Para 8.29) …
>
> "Any assessment of whether delegation or command has occurred would necessarily be in reference to that which has been delegated or commanded and in reference to the one to whom it has been delegated or commanded. As aspects of and flowing from the first element of the definition, the second and third elements provide further support for our view that the action must be an explicit and affirmative act of delegation or command. We note, in this regard, that the "entrusts or directs" language in subparagraph (iv) is followed by the language "a private body to carry out . . . ", which is similar to that which we have used to describe the second and third elements of the definition of entrustment or direction. Thus, the subsequent language in subparagraph (iv) confirms

our view of the requirement of an explicit and affirmative action". (Para 8.30)

1.46. <u>Article 1.1(a)(1)(iv)</u> ("a government entrusts or directs")
(Is existence of financial contribution to be determined solely on the basis of the reaction to that measure or it must be proved by reference to the action of the government?)

In the dispute *US - Exports Restraints*, the Panel's understanding of US's view was that:

> **"**where the effect of an export restraint is to induce domestic producers to sell their product (in greater quantities or exclusively) to the domestic purchasers/users of that product, this is the same as if the government had explicitly and affirmatively ordered the domestic producers to do so, and that thus there is a financial contribution in the form of government-entrusted or government-directed provision of goods. In forwarding this argument of "functional equivalence" or "conceptual equivalence", the United States focuses primarily on the effects or the results of a government action, rather than on the nature of the action, in order to determine whether that action constitutes a financial contribution. Thus, according to the US approach, the existence of a financial contribution in the case of an export restraint depends entirely on the reaction thereto of the producers of the restrained good, and specifically on the extent to which they increase their domestic sales of the restrained product because of the restraint". (Para 8.33)
>
> "It cannot be the case that the nature of a Member government's measure under the SCM Agreement is to be determined solely on the basis of the reaction to that measure by those it affects. Rather, the existence of a financial contribution by a government must be proven by reference to the action of the government. To determine whether a financial contribution exists under subparagraph (iv) solely by reference to the reaction of affected entities would mean in practice that a different standard would apply under that provision as compared to the standard under subparagraphs (i)-(iii), which involves consideration of the action of the government first. Similarly, we do not see how the reaction of private entities to a given governmental measure can be the basis on which the Member's compliance with its treaty obligations under the WTO is established." (Para 8.34)
> ……
>
> "Moreover, applying the "effects" approach to the question of whether a financial contribution exists would have far-reaching implications. In particular, it would seem to imply that any government measure that creates market conditions favourable to or resulting in the increased supply of a product in the domestic market would constitute a government-entrusted or government-directed provision of goods, and hence a financial contribution." (Para 8.35)

To illustrate the difficulties of the US "effects" approach the Panel considered a hypothetical example:

> "Let us assume that a government imposes extremely high tariffs on imports of coal. It follows that the price of imported coal in the domestic market would increase and the supply thereof would perhaps decrease. Domestic downstream users of coal, such as steel producers, would probably find it more economical to purchase coal from domestic producers, who would thus see an increase in their sales volumes and would be likely to secure better terms of sale as well. A government action – the imposition

of high tariffs on coal – would have benefited producers of coal by causing downstream users of coal to make a greater proportion of purchases from domestic producers vis-à-vis foreign producers as compared to the situation prior to the imposition of such tariffs. Surely this cannot be considered to be a situation where a government "entrusts or directs" a private body (users of coal) to purchase goods within the meaning of subparagraph (iii) – or "entrusts or directs" a private body (producers of coal) to provide goods within the meaning of subparagraph (iii) – and hence to constitute a financial contribution, although that is precisely the result that applying the US "effects" approach would yield. Were that to be the case, tariffs would constitute financial contributions and, given that they would necessarily confer a benefit on some actors in the market, tariffs would constitute subsidies within the meaning of Article 1 of the SCM Agreement." (Para 8.37)

1.47. Article 1.1(a)(1)(iv) ("a government entrusts or directs")
(Difference between government entrustment or direction and government intervention in market in some way)

In the dispute *US - Exports Restraints* the Panel was of the view that:

"Government entrustment or direction is very different from the situation in which the government intervenes in the market in some way, which may or may not have a particular result simply based on the given factual circumstances and the exercise of free choice by the actors in that market. Indeed, governments intervene in markets in various ways, and with various policy or profit objectives, and these interventions might have various results, including results that are not intended by, or that are even undesirable for, the government. We do not see how a scenario of this type would comprise the three elements that we consider to be germane to the definition of entrustment or direction. That is, the fact that two different government actions might happen to have the same result in a given situation does not transform the nature of the actions, i. e., it does not mean that the two actions are effectively one and the same". (Para 8.31)

1.48. Article 1.1(a)(1)(iv) ("a government entrusts or directs")
(Does export restraint satisfy the "entrusts or directs" standard?)

In the dispute *US - Exports Restraints*, the Panel considered whether export restraint (particular fact pattern cited by Canada, i. e., a border measure that takes the form of a government law or regulation which expressly limits the quantity of exports or places explicit conditions on the circumstances under which exports are permitted, or that takes the form of a government-imposed fee or tax on exports of the product calculated to limit the quantity of exports) could be treated as financial contribution . It was of the view that:

"the ordinary meanings of the words "entrusts" and "directs" require an explicit and affirmative action of delegation or command. Moreover, we find that the "effects" test (i. e., a proximate causal relationship) advanced by the United States as the definition of "entrusts or directs" has implications which in our view would be contrary to the intended scope and coverage of the SCM Agreement, in that it would effectively read out of the text of Article 1 the financial contribution requirement. Thus, we find that an export restraint in the sense that the term is used in this dispute cannot satisfy the "entrusts or directs" standard of subparagraph (iv)." (Para 8.44)

1.49. Article 1.1(a)(1)(iv) ("Private body")

(Purpose of "private body" in Article 1.1 (a) (1) (iv))

In the dispute *US - Exports Restraints*, the Panel believed that:

> "the term "private body" is used in Article 1.1(a)(1)(iv) as a counterpoint to "government" or "any public body" as the actor. That is, any entity that is neither a government nor a public body would be a private body. Under this reading of the term "private body", there is no room for circumvention in subparagraph (iv). As it is a government or a public body that would have to entrust or direct under subparagraph (iv), any entity other than a government or a public body could receive the entrustment or direction and could constitute a "private body". (Para 8.49)

1.50. <u>Article 1.1(a)(1)(iv)</u> ("To carry out one or more of the type of functions illustrated in (i) to (iii) above")
(Does the phrase "type of functions" expand the scope of subparagraph (iv) beyond the physical functions encompassed by subparagraphs (i)- (iii) ?)

In the dispute *US - Exports Restraints* before the Panel US argued that subparagraph (iv) encompasses a "wide spectrum of potentially actionable government mechanisms", inter alia, export restraints. In particular, the United States argued that the word "type" means "the general form, structure, or character distinguishing a particular group or class of thing", and on this basis argued that the inclusion of this word suggests that functions of the same general form, structure, or character as those illustrated in subparagraphs (i)-(iii) would likewise constitute the indirect provision of a financial contribution. Canada considered that the phrase "one or more of the type of functions illustrated in (i) to (iii)" refers only to any one of the functions listed in subparagraphs (i)-(iii), and that an export restraint, a direction not to export, is not the same "type" of function as an affirmative direction to provide goods domestically.

The Panel found no support in the text of the Agreement for reading of the word "type" as being argued by the US. In its view:

> " the phrase "type of functions" refers to the physical functions identified in subparagraphs (i)-(iii). In this regard, we believe that the intention of subparagraph (iv) is to avoid circumvention of subparagraphs (i)-(iii) by a government simply by acting through a private body. Thus, ultimately, the scope of the actions (the physical functions) covered by subparagraph (iv) must be the same as those covered by subparagraphs (i)-(iii). That is, the difference between subparagraphs (i)-(iii) on the one hand, and subparagraph (iv) on the other, has to do with the identity of the actor, and not with the nature of the action. The phrase "type of functions" ensures that this is the case, that is, that Article 1 covers the types of functions identified in subparagraphs (i)-(iii) whether those functions are performed by the government itself or are delegated to a private body by the government." (Para 8.53)

As for the specific word "type" the Panel saw this as referring to:

> "the fact that each of subparagraphs (i)-(iii) constitutes by itself a general "type of functions" that encompasses one or more categories of behavior. The subsequent phrase "illustrated in (i) to (iii) above" confirms this. In particular, subparagraphs (i)-(iii) each refer to multiple government actions and provide examples thereof. Subparagraph (i), for instance, refers to three general categories (direct transfers of funds; potential direct transfers of funds; and potential direct transfers of liabilities) of

the "type of function" of transfers of funds and liabilities." (Para 8.54)

The Panel therefore found that "the phrase "type of functions" "refers to the physical functions encompassed by subparagraphs (i)-(iii), and does not expand the scope of subparagraph (iv) beyond these, to encompass other kinds of "government mechanisms". (Para 8.55)

1.51. <u>Article 1.1(a)(1)(iv)</u> ("which would normally be vested in the government" and "the practice, in no real sense, differs from practices normally followed by governments") (Can the phrases "which would normally be vested in the government" and "the practice, in no real sense, differs from practices normally followed by governments" include various functions of the government like taxation and/or subsidization?)

In the dispute *US - Exports Restraints* Canada argued that in the case where the government entrusts or directs a private body to carry out one of the functions listed in subparagraphs (i)-(iii), the function must be one that would normally be vested in the government, and must not differ in any real sense from practices normally followed by governments. In Canada's view, the drafting of this text indicates that these conditions are requirements, specifically of a habitual practice by a government of engaging in one of the functions enumerated.

The United States, for its part, argued that the functions identified in subparagraphs (i)-(iii) are "normal" government functions in the context of government provision of subsidies. The United States submitted that the "normally vested" and "in no real sense differs" language originated in the 1960 report of the Panel on Review Pursuant to Article XVI:5, in which similar language was used in respect of producer-funded levies that were deemed not to differ, in any real sense, from government practices of taxation and subsidization (That Panel referred to the government taking part "either by making payments into a common fund or entrusting to a private body the functions of taxation and subsidisation with the result that the practice would in no real sense differ from those normally followed by governments"). Thus, for the United States, these last elements of Article 1.1(a)(1)(iv) mean that the functions in question are those where the government would be engaged in taxation and/or subsidisation, which in the US view could include the instituting of an export restraint.

The Panel believed that:

> " under such an approach, any government market intervention that involved a reallocation of resources which created a benefit would be viewed as involving "subsidisation" in the broad sense used by the United States, and thus as satisfying the financial contribution requirement. In other words, under this approach, subparagraph (iv) would treat as financial contributions government actions that created "benefits" even when those actions were not among the functions encompassed by subparagraphs (i)-(iii)." (Para 8.58)

The Panel did not consider that making a finding regarding the precise meaning of the words "normally vested" and "in no real sense differs" was necessary to resolve the dispute. It however did not see "how Canada's argument, that the "normally vested" and "in no real sense differs" language narrows the circumstances in which there would be government entrustment or direction of the provision of goods, would rule out the possibility that an export restraint could potentially constitute such a provision of goods." (Para 8.59)

1.52. Article 1.1 (b) ("benefit")
(What is the benchmark for determination of benefit?)

In the dispute of *Korea – Commercial Vessels*, the Panel while looking into the allegation of the European Communities that corporate restructuring measures such as debt forgiveness, debt and interest relief etc led to granting of benefit, noted that it is now well established that the existence of benefit is determined by reference to the market. The Panel stated that to the issue of benefit in the context of restructuring is to ask whether the European Communities had demonstrated that either the decision to restructure or the terms were commercially unreasonable with respect to each of the restructurings. The Panel noted that the European Communities has failed to demonstrate the same. (Paras 7.427 – 428, 7.515)

1.53. Article 1.1(b) ("benefit is thereby conferred")
(Meaning of benefit)

In the dispute *Canada Aircraft*, the Panel has given its clarification regarding the meaning of benefit. In its opinion "the ordinary meaning of "benefit" clearly encompasses some form of advantage. We do not consider that the ordinary meaning of "benefit" per se includes any notion of net cost to the government." (Para 9.112)

1.54. Article 1.1(b) ("a benefit is thereby conferred")
(Can "benefit" arise in absence of a person – natural or legal?)

In the dispute *Canada- Civilian Aircraft*, Canada appealed the Panel's legal interpretation of the term "benefit" in Article 1.1(b) of the *SCM Agreement*. In Canada's view, the Panel erred in its interpretation of "benefit" by focusing on the commercial benchmarks in Article 14 "to the exclusion of cost to government", and by rejecting Annex IV as relevant context.

It was the view of the Appellate Body that:

> **"**A "benefit" does not exist in the abstract, but must be received and enjoyed by a beneficiary or a recipient. Logically, a "benefit" can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something. The term "benefit", therefore, implies that there must be a recipient. This provides textual support for the view that the focus of the inquiry under Article 1.1(b) of the SCM Agreement should be on the recipient and not on the granting authority. The ordinary meaning of the word "confer", as used in Article 1.1(b), bears this out. "Confer" means, inter alia, "give", "grant" or "bestow". The use of the past participle "conferred" in the passive form, in conjunction with the word "thereby", naturally calls for an inquiry into what was conferred on the recipient. Accordingly, we believe that Canada's argument that "cost to government" is one way of conceiving of "benefit" is at odds with the ordinary meaning of Article 1.1(b), which focuses on the recipient and not on the government providing the "financial contribution". (Para 154)

1.55. Article 1.1(b) ("benefit is….conferred")
(Are the provisions concerning valuation of subsidies relevant for establishing the existence of a subsidy)

In the dispute *Canada Aircraft* it was the opinion of the Panel that:

"The need to calculate the value of a subsidy only arises once the existence of the subsidy, and therefore the "financial contribution" and "benefit", have been established. Because "benefit" must be established before the value of the alleged subsidy may be considered, provisions concerning the valuation of subsidies are not necessarily relevant for the purpose of establishing the existence of a subsidy (and therefore "benefit")."(Para 9.116)

1.56. Article 1.1(b) "benefit is….conferred"
(Does a loan at market rate confer a benefit?)

In the dispute *Canada Aircraft*, the Panel was of the view that that a "loan at the market rate" would not confer a "benefit" within the meaning of Article 1.1(b) of *the SCM Agreement*. (Para 9.277)

1.57. Article 1.1(b) ("benefit is….conferred")
(Obligation on the responding party to demonstrate that no benefit is conferred)

In the dispute *Canada Aircraft*, the Panel was of the view that that the responding country must do more than simply demonstrate that the amount of specific "benefit" estimated by complaining country may be incorrect. Rather, the responding country must demonstrate that no "benefit" is conferred, in the sense that the terms of the contribution provide for a commercial rate of return. (Para 9.312)

1.58. Article 1.1(b) ("a benefit is thereby conferred")
(Basis for comparison in determining whether a benefit has been conferred)

In the dispute *Canada Civilian Aircraft* the Appellate Body believed that:

" The word "benefit", as used in Article 1.1(b), implies some kind of comparison. This must be so, for there can be no "benefit" to the recipient unless the "financial contribution" makes the recipient "better off" than it would otherwise have been, absent that contribution. In our view, the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market." (Para 157)

"Article 14, which we have said is relevant context in interpreting Article 1.1(b), supports our view that the marketplace is an appropriate basis for comparison. The guidelines set forth in Article 14 relate to equity investments, loans, loan guarantees, the provision of goods or services by a government, and the purchase of goods by a government. A "benefit" arises under each of the guidelines if the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market." (Para 158)

1.59. Article 14 and Article 1.1(b) ("benefit")
(Can the commercial benchmarks applied for Article 14 be relevant for determining when on Article 1.1(b) benefit arises?)

In the dispute *Canada Aircraft*, the Panel was of the view that "Article 14 refers expressly to commercial benchmarks for identifying explicit situations in which an Article 1.1 "benefit" shall not arise. We see no reason why the commercial benchmarks applied in Article 14 for the purpose of determining when an Article 1.1 "benefit" does not arise

should not serve as relevant context for determining when an Article 1.1 "benefit" does arise."(Para 9.113)

1.60. Article 1.1(b) ("benefit is thereby conferred")
(Can benefit be conferred on production facilities?)

In the dispute *US Lead Bismuth* before the Panel US argued that subsidies were bestowed on the production of leaded bars produced by UES and BS. During the underlying countervailing duty investigations USDOC had found that "benefit" conferred on BSC by pre 1985/86 "financial contribution" to BSC passed through, in part to UES. In its 1993 Leaded Bars determination, the USDOC "calculate[d] the benefit from prior subsidies which passed through from BSC to UES" when UES acquired BSC's Special Steels Business, the latter considered by the USDOC to be a "productive unit." The USDOC explained that "[w]hen a productive unit is sold by a company which continues to operate (such as BSC), the potentially allocable subsidies which could have travelled with the productive unit, but did not because they were accounted for as part of the purchase price, simply stay with the selling company. As such, they have not been extinguished. Instead, they continue to benefit the seller and our calculation represents the allocation of the subsidies between the seller and the productive unit it has sold." As a result, the USDOC imposed countervailing duties on imports of leaded bars produced by UES, based on that portion of "benefit" from prior subsidies that was deemed by the USDOC to have passed through to UES.

The issue before the Panel was whether benefits conferred on BSC were passed on to UES, which acquired part of BSC's business, as these were bestowed on the production facilities of leaded bars. It was the view of the Panel that "the existence or non-existence of "benefit" rests on whether the potential recipient or beneficiary, which "logically" must be a legal or natural person, or group of persons, has received a 'financial contribution' on terms more favourable than those available to the potential recipient or beneficiary in the market." (Para 6.66)

The Panel also considered Article VI:3 of GATT 1994 and Footnote 36 to Article 10 of ASCM and concluded that "in the context of countervailing duty investigations, the existence of a "benefit" should be determined by reference to the market terms on which a "financial contribution" bestowed directly or indirectly upon the production of any merchandise would have been made available to the producer of that merchandise. Thus, in order to determine whether any subsidy was bestowed on the production by UES and BSplc/BSES respectively of leaded bars imported into the United States in 1994, 1995 and 1996, it is necessary to determine whether there was any "benefit" to UES and BSplc respectively (i.e., the producers of the imported leaded bars at issue)." (Para 6.69)

The Appellate Body upheld the finding of the Panel in this regard.

1.61. Article 1.1 (b) ("benefit is thereby conferred")
(In case of change in ownership of a company, is there a need to determine "benefit" in respect of the successor companies?)

In the dispute *US Lead Bismuth* before the Panel US argued that there is no need to determine "benefit" in respect of successor companies, because there is an "irrebuttable presumption" that "benefit" continues to flow from untied, non-recurring "financial contributions", even after changes in ownership. The European Communities argued that any such presumption can never be "irrebuttable". While agreeing with the EC in this

regard the Panel considered that "the presumption of "benefit" flowing from untied, non-recurring "financial contributions" is rebutted in the circumstances surrounding the changes in ownership leading to the creation of UES and BSplc/BSES respectively. In such circumstances, the continued existence of "benefit" to UES and BSplc/BSES respectively must be demonstrated." (Bsplc and BSES are the successor companies) (Para 6.71)

1.62. <u>Article 1.1(b)</u> ("benefit is thereby conferred")
(During what period should financial contribution and benefit exist?)

In the dispute *US Lead Bismuth* before the Panel US argued that Article 1.1(b) of the ASCM only requires "benefit" to be established once, as of the time of bestowal of the "financial contribution". The United States based the argument on the fact that Article 1.1 describes the relevant "financial contribution" and "benefit" in the present tense. According to the United States, "the ordinary meaning arising from the use of the present tense to describe both elements is that Article 1.1 is concerned with, and requires the identification of, the 'benefit' that is conferred at the time that the government provides the 'financial contribution'".

The Panel was not convinced by the US interpretation of the use of present tense in Article 1.1. According to the Panel the use of the present tense simply means that the requisite "financial contribution" and "benefit" must exist during the relevant period of investigation or review. The use of the present tense does not speak to the issue of whether or not the existence of "benefit" should be determined at the time of bestowal of the "financial contribution", or whether or not there is any need for any subsequent review of the original determination of "financial contribution" and / or "benefit". It simply means that when an investigation or review takes place, the investigating authority must establish the existence of a "financial contribution" and "benefit" during the relevant period of investigation or review. Only then will that investigating authority be able to conclude, to the satisfaction of Article 1.1 (and Article 21), that there is a "financial contribution", and that a "benefit" is thereby conferred. (Para 6.73)

1.63. <u>Article1.1(b)</u> ("Benefit is thereby conferred")
(Is the investigating authority required to demonstrate existence during the period of investigation or review, of a continued "benefit" from a prior "financial contribution" or should the investigating authority demonstrate the existence of benefit only at the time the financial contribution was made?)

In the dispute *US Lead Bismuth*, the United States appealed the Panel's finding that the investigating authority must demonstrate the existence, during the relevant period of investigation or review, of a continued "benefit" from a prior "financial contribution". The United States argued that the use of the present tense of the verb "is conferred" in Article 1.1 of the *SCM Agreement* shows that an investigating authority must demonstrate the existence of "benefit" only at the time the "financial contribution" was made. The United States also relied on the context of Article 1.1, in particular Articles 14 and 27.13 of the *SCM Agreement*, in support of this interpretation.

According to the Appellate Body "Article 1.1 sets out the definition of a subsidy for the purposes of the SCM Agreement. However, Article 1.1 does not address the time at which the "financial contribution" and/or the "benefit" must be shown to exist". Appellate Body therefore considered that "Article 1.1 does not provide a basis for the argument made by the United States". It also found nothing in Articles 14 or 27.13 of the *SCM Agreement* that supports the United States' position. (Para 60)

1.64. Article 1.1 (b) ("benefit is thereby conferred")
(Under what circumstances is the benefit bestowed on a company prior to the privatization relevant for determining benefits to the successor company)

In the dispute *US Lead Bismuth* an issue before the Panel was whether benefits bestowed on a company subsequently privatized at arm's length, for fair market value and consistent with commercial considerations "flowed" to the successor company. The Panel noted that fair market value was paid for all productive assets, goodwill etc. employed by the company prior to privatization, and it failed to see how benefits conferred prior to privatization could subsequently be considered to confer a benefit on successor companies. However, the Panel further noted that "if a fair market value was not paid for all productive assets acquired during privatization, then non recurring financial contribution bestowed prior to privatization would continue to confer benefits to the successor or company." The Panel considered that an untied non-recurring "financial contribution" bestowed on a prior company may constitute "financial contribution" indirectly on a successor company. This is because the untied, non-recurring "financial contribution" will be deemed to have been invested in the productive assets etc. of that company.

Thus, when those productive assets etc. are acquired by the successor company, the successor company indirectly acquires the "financial contribution" embodied in those productive assets etc. Assuming "financial contribution" bestowed directly on BSC could be deemed to have been bestowed indirectly on UES and BSplc/BSES (the successor companies), this fact alone would not mean that pre 1985-86, untied, non-recurring "financial contributions" bestowed on BSC necessarily confer any benefit on UES or BSplc/BSES. This would only be the case if those "financial contributions were found to have been bestowed indirectly (i.e. through the relevant change in ownership transactions) on UES and BASplc/BSES respectively on terms more favourable than UES and BSplc. BSES respectively could have been obtained in the market. We consider that such a finding would only be possible if fair market value was not paid for all productive assets etc. acquired by UES and BSplc/BSES respectively from BSC. Since fair market value was paid for all such productive assets etc., we do not consider that any untied, non-recurring "financial contribution: bestowed indirectly on UES and BSplc/BSES could be deemed to confer a "benefit" on those entities." (Para 6.81)

1.65. Article 1.1(b) ("Benefit is thereby conferred")
(Whether financial contribution confers a benefit?)

In the dispute *US Lead Bismuth*, the Appellate Body was of the view that the question whether a "financial contribution" confers a "benefit" depends, therefore, on whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market. (Para 68)

1.66. Article 1.1(b) ("benefit")
(Does benefit depend upon a comparison with advantages available to a competing product from another country?)

In the dispute *Brazil Aircraft* the Panel considered whether "benefit exists" depending upon a comparison with advantages available to a competing product from another member. According to the Panel "although the concept of benefit is not defined in the SCM Agreement, its application in various circumstances suggests that one should examine objective benchmarks, whether involving a comparison of the terms of the financial

contribution to a market benchmark reflecting the terms under which the beneficiary of the financial contribution would be operating in the absence of the government financial contribution (as provided for in the calculation of the amount of the subsidy in terms of benefit to the recipient in a countervailing duty context under Article 14 of the Agreement) or the existence of a cost to the government in providing the financial contribution (as envisioned by Annex IV relating to the calculation of the ad valorem subsidization for the purposes of the presumption of serious prejudice under Article 6.1(a) of the Agreement). In no case is it suggested that whether or not a benefit exists would depend upon a comparison with advantages available to a competing product from another Member". (Para 7.24)

1.67. Article 1.1(b) ("a benefit is thereby conferred")
(Can interpretation of benefit focus on the commercial benchmark as specified in Article 14?

In the dispute *Canada Civilian Aircraft* it was Canada's view that the Panel erred in its interpretation of "benefit" by focusing on the commercial benchmark in Article 14 to "the exclusion of cost to government".

The Appellate Body considered that:

> "Article 14 constitutes relevant context for the interpretation of "benefit" in Article 1.1(b). It was the view of Appellate Body that although the opening words of Article 14 state that the guidelines it establishes apply "for the purposes of Part V" of the SCM Agreement, which relates to "countervailing measures", our view is that Article 14, nonetheless, constitutes relevant context for the interpretation of "benefit" in Article 1.1(b). The guidelines set forth in Article 14 apply to the calculation of the "benefit to the recipient conferred pursuant to paragraph 1 of Article 1". (emphasis added) This explicit textual reference to Article 1.1 in Article 14 indicates to us that "benefit" is used in the same sense in Article 14 as it is in Article 1.1. Therefore, the reference to "benefit to the recipient" in Article 14 also implies that the word "benefit", as used in Article 1.1, is concerned with the "benefit to the recipient" and not with the "cost to government", as Canada contends." (Para 155)

1.68. Article 1.1(b) ("benefit is thereby conferred")
(If payments are made in support of export credits extended to the purchasers and not the producer, does it confer a benefit to the producer?)

In the dispute *Brazil – Civilian Aircraft Second Recourse by Canada to Article 21.5* the Panel noted that "PROEX III payments are made in support of export credits extended to the purchaser, and not to the producer, of Brazilian regional aircraft". The Panel was of the view that:

> **"**To the extent Canada can establish that PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a prima facie case that the payments confer a benefit on the producers of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products, We do not understand the parties to dispute this proposition."(Footnote 42)

1.69. Article 1.1(b) ("benefit is thereby conferred")
(Standard for per challenge of subsidies schemes)

In the dispute *Canada – Export Credits and Loan Guarantees*, Brazil challenged *per se* Canada's EDC Schemes. It was the view of the Panel that:

> "To satisfy the "benefit" element of Article 1.1 of the S CM Agreement for purposes of a challenge to the EDC Corporate Account as such Brazil must show that the programmes requires conferral of a benefit not that could be used to do so, or even that it is used to do so". (Para 7.107)

1.70. Article 1.1 (b) ("benefit is thereby conferred")
(Does the prescription of a CIRR floor for financing operations establish the absence of a benefit?)

In the dispute *Brazil – Civilian Aircraft Second Recourse by Canada to Article 21.5* Brazil argued that PROEX III did not confer a benefit in respect of regional aircraft as the relevant BCB Resolution 279 establishes a minimum interest rate of CIRR for all PROEX III transactions and employs "international market" benchmark for determining whether PROEX III support should be granted or not. In considering these arguments the Panel was of the view that:

> **"**It is important to bear in mind that the CIRR is "a constructed interest rate for a particular currency, at a particular time, that does not always necessarily reflect the actual state of the credit markets." It is, therefore, at best a rough proxy for commercial interest rates. Moreover, the CIRR is designed to correspond to commercial interest rates for "first-class" borrowers. It is certainly not a precise market proxy for rates which borrowers of lesser creditworthiness could obtain in the market."(Para 5.35)
>
> "Brazil has not suggested to us that all buyers of regional aircraft are first-class borrowers and, hence, could obtain funds at rates close to the CIRR. In fact, there is evidence on record to suggest that many actual or potential buyers of regional aircraft are not first-class borrowers. It follows that, even if the CIRR did accurately reflect commercial market rates for first-class borrowers, the requirement in BCB Resolution 2799 that PROEX III support must not result in net interest rates below the CIRR does not mean that PROEX-supported interest rates are no more favourable than those which particular purchasers of Brazilian aircraft could have obtained in the commercial marketplace. We therefore find that the prescription of a CIRR floor for financing operations involving regional aircraft does not establish the absence of a benefit for the buyers of such aircraft."(Para 3.36)

1.71. Article 1.1(b) ("benefit is conferred")
(Is a benefit conferred merely by the fact that the exporter is able to arrange financing in the form of government support?)

In the dispute *Canada – Export Credits and Loan Guarantees*, Brazil argued that there can be a "benefit" to Bombardier even if there is no "benefit" to the purchasing airline, e.g., even if the EDC provides financing to the purchasing airline on terms that are not more favourable than those that the airline could obtain in the market. "Embraer … offers to arrange financing at γ per cent, while Bombardier is able to provide government financing at γper cent[,] [t]he government support has benefited Bombardier by relieving it of the necessity of providing or arranging its own financing, even though the customer may view the offers as equal, and therefore not be benefited."

The Panel was of the view that the fact that Bombardier may arrange financing in the form of government support does not necessarily confer a "benefit" simply because Bombardier is "reliev[ed] … of the necessity of providing or arranging its own financing". If that were the case, a "benefit" would be conferred whenever Bombardier arranged external financing – even through commercial banks – since any external financing would "reliev[e] it of the necessity of providing or arranging its own financing". We find it difficult to accept that the existence of "benefit" (in the context of financing) is determined on the basis of whether or not Bombardier provides internal or external financing. The existence of "benefit" (in the context of financing) is determined by reference to the terms at which similar financing is available to the airline customer in the market. The abovementioned market comparison indicates that a number of the specific transactions at issue in these proceedings do not confer a "benefit" on the airline customer, and therefore neither on Bombardier. (Para 7.229)

1.72. <u>Article 1.1 (b)</u> ("benefit")
(Relationship between Articles 1.1 (b) and 14 of the SCM Agreement)

In the dispute of *EC – DRAMS Countervailing Measures*, the Panel noted:

> "We note that Article 1.1 of the *SCM Agreement* provides that a subsidy can only be deemed to exist if there is a financial contribution by the government *which confers a benefit.* The existence of a financial contribution by the government is thus necessary but not sufficient in order to conclude that a subsidy has been provided. Only when this financial contribution confers a benefit will a subsidy be deemed to exist. The *SCM Agreement* does not provide a definition of what constitutes a benefit. In our view, the ordinary meaning of the term "benefit" is that of an "advantage", something which leaves the recipient "better off". In light of the fact that the notion of a "benefit" appears to us to be a relative notion, it becomes important to establish the benchmark for determining whether the recipient is *better off* thanks to the financial contribution. Article 14 of the *SCM Agreement* entitled "Calculation of the Amount of a Subsidy in Terms of the Benefit to the Recipient" provides in our view highly relevant context for interpreting the term "benefit" of Article 1.1(b) of the *SCM Agreement*.
>
> Article 14 of the *SCM Agreement* thus refers on each occasion to the market place as the appropriate benchmark for determining the existence of a benefit to the recipient of the financial contribution. In other words, only in cases where the financial contribution provides the recipient with an advantage over and above what it could have obtained on the market will the government's financial contribution be considered to have conferred a benefit and will a subsidy thus be deemed to exist." (Paras 7.173 – 7.174)

2. ARTICLE 2

2.1. Article 2 (Specificity)

(Are crop insurance schemes, available for most crops but not generally available for the entire agricultural sector, specific enough for the purpose of Article 2.1?)

In the dispute of *US Upland Cotton,* Brazil had alleged that crop insurance subsidies given by the US were specific enough to fall within the purview of the *SCM Agreement.* US on the other hand disagreed with the allegation and submitted that the insurance scheme was widely available. The Panel stated that:

> "Crop insurance subsidies are, generally, available for most crops but they are not generally available in respect of the entire agricultural sector in all areas. Each insurance plan is available for a defined list of crops to which the FCIC determines that it is adapted.
>
> There are no subsidized crop insurance policies on the record available to all agricultural producers. They are therefore, in fact, not even generally available to the industry which can be categorized as the agricultural industry.
>
> In our view, the industry represented by a portion of United States agricultural production that is growing and producing certain agricultural crops (and certain livestock in certain regions under restricted conditions) is a sufficiently discrete segment of the United States economy in order to qualify as "specific" within the meaning of Article 2 of the *SCM Agreement.* As a factual matter, we have found that the crop insurance subsidy is not universally available for all agricultural production. Rather, it is generally limited to certain "crops", it differentiates among such crops and it is only available in certain regional "pilot programmes" in respect of livestock.. " (Paras 7.1149 – 7.1152)

2.2. Article 2 (Specificity)

(Is a deliberate limiting of access to certain limited number of enterprises required to prove the requirement of specificity?)

In the dispute of *Softwood Lumber IV,* Canada had argued before the Panel that a member may find that the alleged subsidy is specific in fact only where the total configuration of facts and evidence relating to these factors points to a *deliberate* limiting of access to a certain limited number if enterprise or industries engaged in the manufacture of similar products.

The Panel rejected Canada's argument noting that Article 2 was concerned with the distortion that is created by a subsidy which either in law or in fact is not broadly available. It further stated:

> "While deliberate action by a government to restrict access to a subsidy that is in principle broadly available, through the use of discretion, could well be the basis for a finding of de facto specificity, we see no basis in the text of Article 2, and 2.1 (c) SCM Agreement in particular, for Canada's argument that if the inherent characteristics of the good provided limit the possible use of the subsidy to a certain industry, the subsidy will not be specific unless access to this subsidy is limited to a sub-set of this industry, i.e. to certain enterprises within the potential users of the subsidy engaged in the

manufacture of similar products…Article 2 speaks of the use by a limited number of certain enterprises or the predominant use by certain enterprises, not of the use by a limited number of certain *eligible* enterprises." (Paras 7.115 -116)

2.3. Article 2.1 (a) (Specificity)

(In order for a subsidy to specific is there a requirement that the limitation on access necessarily be set forth explicitly with respect to *both* financial contribution and benefit?)

In the dispute of *US – CVD China (AB)*, China argued that relevant inquiry under Article 2.1(a) is whether the actual words of the legislation limit access to the particular financial contribution *and* its associated benefit that the investigating authority has to satisfy the two-part definition of a 'subsidy' under Article 1 of the *SCM Agreement*. The Appellate Body rejected China's argument and said that:

"We also note that both provisions turn on indicators of eligibility for a subsidy. Article 2.1(a) thus focuses not on whether a subsidy has been granted to certain enterprises, but on whether *access to that subsidy* has been explicitly limited. This suggests that the focus of the inquiry is on whether certain enterprises are eligible for the subsidy, not on whether they in fact receive it. Similarly, Article 2.1(b) points the inquiry towards "objective criteria or conditions governing the eligibility for, and the amount of, a subsidy".

We do not share China's view that the use of the word "subsidy" in the chapeau of Article 2.1 of the SCM Agreement means that each of the definitional elements of a subsidy bears upon the question of whether a subsidy is specific under Article 2.1(a). Rather, what must be made explicit under Article 2.1(a) is the *limitation on access* to the subsidy to certain enterprises, regardless of how this explicit limitation is established. In this respect, we consider that, generally, a legal instrument explicitly limiting access to a financial contribution to certain enterprises, but remaining silent on access to the benefit, would nevertheless constitute an explicit limitation on access to that subsidy." (Paras 368, 377)

2.4. Article 2.1 (a) (Specificity)

(Whether an investigating authority assess assessed specificity at the level of the individual restructurings, rather than at the level of the umbrella law under which the restructurings were conducted?

In the dispute of *Japan – DRAMS CVDs*, Korea argued before the Panel that Japan had acted inconsistently with *SCM Agreement* Article 2 governing "specificity, because the Japan Investigating Authorities (JIA) improperly failed to consider whether the October 2001 and December 2002 restructurings were made using the same procedures and on the same terms that were generally available to other companies in a similar condition, through, inter alia, the Corporate Restructurings Promotion Act (CRPA). The Panel held that there was sufficient evidence on the JIA's record indicating that the CRPA merely provided the procedural framework within which the October 2001 and December 2002 restructurings took place, rather than actually determining the terms of those restructurings. In other words, the restructurings did not "reflect only the normal operation of the CRPA", as alleged by Korea.

The Panel thus rejected Korea's claim and said that following JIA's approach to specificity would mean that investigating authorities would no longer need to show that programmes

were specific, but could focus instead on specific transactions under those programmes. The Panel noted that "if an investigating authority were to focus on an individual transaction, and that transaction flowed from a generally available support programme whose normal operation would generally result in financial contributions on pre-determined terms (that are therefore not tailored to the recipient company), that individual transaction would not … become 'specific' in the meaning of Article 2.1 simply because it was provided to a specific company." Instead, an individual transaction would be "specific" if it resulted from a framework programme whose normal operation:

(1) does not generally result in financial contributions, and
(2) does not predetermine the terms on which any resultant financial contributions might be provided, but rather requires
    (a) conscious decisions as to whether or not to provide the financial contribution (to one applicant or another), and
    (b) conscious decisions as to how the terms of the financial contribution should be tailored to the needs of the recipient company. (Para 7.374)

2.5. Article 2.1 (c) (*De facto* Specificity)
(Factors to be taken into account for determining *de facto* specificity)

In the dispute of *EC - DRAMS Countervailing Measures*, the Panel evaluated alleged subsidies under Korea Development Bank (KDB) Debenture Program in the light of Article 2.1 (c) and after considering the four factors listed in Article 2.1 (c), held in favour of the European Communities concluding that the KDB Debenture Programme was de facto specific for Hynix Semiconductor. For instance, there was limited use of the KDB Debenture Programme by a small number of companies – six out of a potential of more than 200 eligible companies – and the disproportionate use of the funds under the programme by Hynix Semiconductor, which used up to 41 per cent of the total funds under the programme. (Paras 7.223 - 230)

2.6. Article 2.1 (c) ("account shall be taken of the extent of diversification.. ")
(How can an investigating authority show it had taken account of the extent of economic diversification?)

In the dispute of *Softwood Lumber IV*, the Panel stated that while the US Department of Commerce had not explicitly and as such addressed the extent of economic diversification, noting that the vast majority of companies and industries in Canada did not receive benefits under these programmes showed that it had taken account of the extent of economic diversification. (Para 7.124)

2.7. Article 2.2 (Regional specificity)
(Whether in evaluating a subsidy under Article 2.2, a finding of subsidy be based solely on financial contribution rather than geographical limitation?)

In the dispute of *US – CVD China (AB)*, the Appellate Body on China's appeal that a subsidy finding under Article 2.2 cannot be solely based on financial contribution held:

> "… the purpose of Article 2 of the *SCM Agreement* is not to identify the elements of the subsidy as set out in Article 1.1, but to establish whether the availability of the subsidy is limited inter *alia* by reason of the eligible recipients (Article 2.1(a)) or by reason of the geographical location of beneficiaries (Article 2.2). We also consider that a limitation on access to a subsidy may be established in many different ways and that,

whatever the approach investigating authorities or Panels adopt, they must ensure that the requisite limitation on access is clearly substantiated on the basis of positive evidence. We consider that, under Article 2.2, as under Article 2.1(a), *a limitation on access to a financial contribution will also limit access to any resulting benefit, since only those obtaining the financial contribution can be beneficiaries of that subsidy*." (Para 413)

2.8. Article 2.2 ("certain enterprises")
(Whether 'certain enterprises' covers all enterprises located within the designated geographical region within the jurisdiction of the granting authority?)

In the dispute of *US – CVD China*, US and China disagreed whether the reference to "certain enterprises" meant that for specificity in the sense of Article 2.2 of the *SCM Agreement* to exist, there must be a limitation of a subsidy to a subset of enterprises allocated within a designated geographical region, or instead whether limitation of a subsidy on a purely geographical basis to part of the territory within the jurisdiction of the granting authority, is sufficient.

The US argued that reference to 'certain enterprises' in Article 2.2 serves to distinguish those enterprises within the designated region from those outside it. On the other hand, China argued that the phrase means that only if a subsidy is limited to some subset of enterprises within the region is that subsidy regionally specific. The Panel concluded that 'certain enterprises" in Article 2.2 "refers to those enterprises located within, as opposed to outside, the designated geographical region in question, with no further limitation within the region being required."(Paras. 9.125-135)

2.9. Article 2.2 ("designated geographical region")
(Whether a "designated geographical region" must necessarily have some sort of formal administrative or economic identity?)

In the dispute of *US – CVD China*, China submitted before the Panel that a designated geographical region must necessarily have some formal economic or administrative identity. It refuted the argument that any identified tract of land within the territory of a granting authority can be a 'designated geographical region' for the purpose of specificity under Article 2.2. The Panel rejected China's claim and held that:

"…we find no limitation of the kind advanced by China, nor does China point to one. Thus, the text *on* its own would appear to allow any identified tract of land within the jurisdiction of a granting authority to be a "designated geographical region" in the sense of Article 2.2 of the SCM Agreement.

…we conclude that a "designated geographic region" in the sense of Article 2.2 of the SCM Agreement can encompass any identified tract of land within the jurisdiction of a granting authority." (Paras 9.140 - 144)

3. ARTICLE 14

3.1. Article 14 Chapeau (Methods of calculating benefit) (What is the scope of coverage of Article 14 and whether it includes methods for allocating benefit and for calculating interest rate?)

In the dispute of *Japan- DRAMS CVDs (AB)*, Japan argued that the Panel had erred in concluding that Japan Investigating Authorities (JIA) had acted contrary to the chapeau of Article 14 as it had used methods not provided for in national legislation or implementing regulations of Japan. Japan claimed that the Panel erred in finding that the two mathematical formulae used in the calculation of benefit (Formula 1 and 2) were 'methods used' under the chapeau of Article 14 since these were only application of the methods provided for in Japan's national regulations.

The Appellate Body agreed with the Panel that Formula 1 and Formula 2 could be considered "methods" in the sense of a "mode of procedure." However, this did not mean they were the "method[s] used" for calculating the amount of benefit in this case. Rather, they were "methods for *allocating benefit* once the amount of the benefit has been determined, and for *calculating interest rates* for loans to uncreditworthy companies where no comparable loans exist on the commercial market." (Paras 199-200). The Appellate Body thus reversed the Panel's finding "that the methods used by Japan to calculate the amount of benefit conferred on Hynix were not provided for in Japan's national legislation or implementing regulations, as required under the chapeau of Article 14 of the *SCM Agreement*. (Para 202)

3.2. Article 14 Chapeau (Methods of calculating benefit) (What are the three requirements in chapeau for calculating benefit?)

In the dispute of *Japan- DRAMS CVDs (AB)*, the Appellate Body noted:

> "The chapeau of Article 14 sets out three requirements. The first is that "any method used" by an investigating authority to calculate the amount of a subsidy in terms of benefit to the recipient shall be provided for in the national legislation or implementing regulations of the Member concerned. The second requirement is that the "application" of *that* method in each particular case shall be transparent and adequately explained. The third requirement is that "any such method" shall be consistent with the guidelines contained in paragraphs (a)-(d) of Article 14. (Para 190)

3.3. Article 14 Chapeau (Methods of calculating benefit) (Is more than one method available for calculating benefit as per the chapeau?)

The Appellate Body in *Japan- DRAMS CVDs (AB)* noted that:

"The chapeau of Article 14 provides a WTO Member with some latitude as to the method it chooses to calculate the amount of benefit. Paragraphs (a)-(d) of Article 14 contain general guidelines for the calculation of benefit that allow for the method provided for in the national legislation or regulations to be adapted to different factual situations. As the Appellate Body said in *US – Softwood Lumber IV*:

> "The chapeau of Article 14 requires that "any" method used by investigating authorities to calculate the benefit to the recipient shall be provided for in a WTO Member's legislation or regulations ... The reference to "any" method in the

> chapeau clearly implies that more than one method consistent with Article 14 is available to investigating authorities for purposes of calculating the benefit to the recipient.'
>
> ... We agree with the Panel that the term "shall" in the last sentence of the chapeau of Article 14 suggests that calculating benefit consistently with the guidelines is mandatory. We also agree that *the term "guidelines" suggests that Article 14 provides the "framework within which this calculation is to performed", although the "precise detailed method of calculation is not determined".* Taken together, *these terms establish mandatory parameters within which the benefit must be calculated, but they do not require using only one methodology for determining the adequacy of remuneration for the provision of goods by a government.* (emphasis added) "" (Paras 190 - 192)

Further, in the dispute of *Softwood Lumber IV (AB)*, the Appellate Body had also looked into the term 'any method' while evaluating whether investigating authorities can look into benchmark other than private prices. It noted that the chapeau of Article 14 requires that "any" method used by investigating authorities to calculate the benefit to the recipient shall be provided for in a WTO Member's legislation or regulations, and it requires that its application be transparent and adequately explained. It inferred that the reference to "any" method in the chapeau clearly implies that more than one method consistent with Article 14 is available to investigating authorities for purposes of calculating the benefit to the recipient.

The Appellate Body in *Softwood Lumber IV (AB)* thus concluded that the Panel's interpretation of paragraph (d) that, whenever available, private prices have to be used exclusively as the benchmark is not supported by the text of the chapeau, which gives WTO Members the possibility to select any method that is in conformity with the "guidelines" set out in Article 14. However, the Appellate Body also noted that:

> "… contrary to the views of the Panel, that guideline does not require the use of private prices in the market of the country of provision in every situation. Rather, that guideline requires that the method selected for calculating the benefit must relate or refer to, or be connected with, the prevailing market conditions in the country of provision, and must reflect price, quality, availability, marketability, transportation and other conditions of purchase or sale, as required by Article 14(d)." (Paras 91 - 96)

3.4. <u>Article 14</u> (Calculation of the amount of the benefit)
(Relationship between Articles 1.1 (b) and 14 of the SCM Agreement)

Refer 1.72 above.

3.5. <u>Article 14</u> (Calculation of the amount of the benefit)
(Use of "grant methodology" for calculation of the amount of benefit and the difference between 'grant' on one hand and loan and loan guarantee on the other hand?)

In the dispute of *EC – DRAMS Countervailing Measures*, the Panel rejected the use of grant methodology by the European Communities' investigating authority. The investigating authority found that the record showed that the financial situation of Hynix Semiconductor (the alleged recipient of subsidy by the Korean government) was such that no reasonable private investor would have been willing to provide funds to this company,

whether in the form of a loan, a loan guarantee or an equity fusion as it was clear that the of chances of recovering the money invested was minimal. Thus, the European Communities argued that the benefit "consisted of the financing which no reasonable investor would have provided to Hynix Semiconductor, and the alleged subsidy programmes were all, irrespective of their terms and conditions, treated as grants." (Para 7.211)

The Panel noted that:

> "In our view, there is a basic problem with the EC's grant methodology, and that is, simply put that a loan, a loan guarantee, a debt-to-equity swap that requires the recipient to repay the money or to surrender an ownership share in the company is not the same as a grant and can not reasonably be considered to have conferred the same benefit as the provision of funds without any such obligation. For the recipient, a loan clearly has a different value than a grant as it involves a debt that is owed to someone and will appear as such in a company's balance sheet. It is thus obviously less beneficial for a company to be given a loan than it is to be given a grant. Similarly, the issuance of new equity, directly or through a debt-to-equity swap dilutes the ownership claims of existing shareholders. We note that, in a benefit analysis, it is the perspective of the recipient that is important, not that of the provider of the financial contribution. In that sense, we find erroneous the starting point of the EC's calculation of the amount of benefit, which focuses on the expectation of the provider of the funds to see his money back. The question of benefit is not about the cost to the provider of the financial contribution, it is about the benefit to the recipient." (Para 7.212)

3.6. <u>Articles 14 (a) and 14 (b)</u> (Calculation of the amount of the benefit) (Is the outside / inside investor benchmark relevant for calculation of benefit?)

In the dispute of *Japan- DRAMS CVDs (AB)*, Japan contested that the Panel had erred in concluding that Japan Investigating Authorities (JIA) had acted inconsistently with the *SCM Agreement* by using an exclusive outside investor benchmark. The Appellate Body stated that:

> "We do not consider the distinction between inside and outside investors to be helpful in order to determine the appropriate benchmark for calculating the amount of benefit under Articles 1.1(b) and 14 of the *SCM Agreement*. The terms of a financial transaction must be assessed against the terms that would result from unconstrained exchange in the relevant market. The relevant market may be more or less developed; it may be made up of many or few participants. By way of example, there are now well-established markets in many economies for distressed debt, and a variety of financial instruments are traded on these markets. In some instances, the market may be more rudimentary. In other instances, it may be difficult to establish the relevant market and its results. But these informational constraints do not alter the basic framework from which the analysis should proceed. We also do not consider that there are different standards applicable to inside and to outside investors. There is but one standard—the market standard—according to which rational investors act." (Para 172)

The Appellate Body thus concluded under Article 14(a), the benchmark is "the usual investment practice of private investors", and under Article 14(b), the benchmark is "the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market." Neither of these benchmarks makes a distinction between "outside" or "inside" investors. (Para 173)

3.7. <u>Article 14 (b) and (c)</u> ("comparable commercial loan")
(What is the appropriate methodology for calculation of benefit in the absence of comparable commercial loan?)

In the dispute of *EC – DRAMS Countervailing Measures*, the Panel noted in the absence of a comparable commercial loan, a reasonable methodology was required to be adopted. It stated:

> "We realize that it may be difficult to directly apply Article 14 of the *SCM Agreement* which contains guidelines for the calculation of the subsidy in terms of the amount of the benefit. In the absence of a comparable commercial loan, it may well be difficult to apply for example Article 14(b) dealing with loans and referring the investigating authority to a comparable commercial loan that could actually be obtained on the market. Article 14(c) refers to a comparable commercial loan, which may well be difficult to find. In light of these problems dealing with the prescribed methodology for calculating benefit in Article 14 of the *SCM Agreement*, we consider that an investigating authority is entitled to considerable leeway in adopting a *reasonable methodology*. Any methodology used must, in our view, reflect the fact that the situation of Hynix is less favourable in case it has to repay the money provided, or dilute the ownership of existing shareholders, compared to the situation that it could keep the money provided in the form of a grant." (Para 7.213)

The Panel opined that in its view the European Communities must base its calculation of benefit on alternative benchmarks in Korea or elsewhere and such an alternate methodology could, for example, include the investment practices related to 'junk bonds' and 'vulture funds'. (Para 7.213, Footnote 186)

3.8. <u>Article 14 (b)</u> ("comparable commercial loan")
(What are the constituent elements of a comparable commercial loan under Article 14 (b)?)

In the dispute of *US – CVD China (AB)*, the Appellate Body discussed some of the *constituent elements of a comparable commercial loan* under Article 14(b). Key rulings of the Appellate Body are given below:

a. A benchmark loan under Article 14(b) must be a loan that is "comparable" to the investigated government loan. Comparable is defined as "able to be compared", "worthy of comparison", and "fit to be compared (to)". This, suggests that something can be considered "comparable", when there are sufficient similarities between the things that are compared as to make that comparison worthy or meaningful. Thus, a benchmark loan under Article 14(b) should have as many elements as possible in common with the investigated loan to be comparable.

b. The term "commercial" is defined as "interested in financial return rather than artistry; likely to make a profit; regarded as a mere matter of business". Thus the term "commercial" does not speak of the identity of the provider of the loan.

c. It would not be correct to conclude that any loan made by the government (or by private lenders in a market dominated by the government) would *ipso facto* not be "commercial". We see nothing to suggest that the notion of "commercial" is *per se* incompatible with the supply of financial services by a government. Therefore, the mere fact that loans are supplied by a government is not in itself sufficient to establish

that such loans are not "commercial" and thus incapable of being used as benchmarks under Article 14(b) of the *SCM Agreement*.

d. There are no inherent limitations in Article 14(b) that would prevent an investigating authority from using as benchmarks interest rates on loans denominated in currencies other than the currency of the investigated loan, or from using proxies instead of observed interest rates, in situations where the interest rates on loans in the currency of the investigated loan are distorted and thus cannot be used as benchmarks.

e. In spite of the different formulations used in Article 14(b) and (d), some of the reasoning of the Appellate Body in *US – Softwood Lumber IV* concerning the use of out-of-country benchmarks and proxies under Article 14(d) is equally applicable under Article 14(b). In particular, we are of the view that a certain degree of flexibility also applies under Article 14(b). At the same time, when an investigating authority resorts to a benchmark loan in another currency or to a proxy, it must ensure that such benchmark is adjusted so that it approximates the "comparable commercial loan". (Paras 471 - 490)

3.9. <u>Article 14(d)</u> ("In relation to")
(Is the phrase 'in relation to' same as 'in comparison with'?)

In the dispute of *Softwood Lumber IV (AB)*, one of the issues contested before the Appellate Body was the interpretation of the phrase 'in relation to' by the Panel. The Panel had reasoned that the phrase "in relation to" in the context of Article 14(d) means "in comparison with". Hence, the Panel concluded that the determination of the adequacy of remuneration had to be made "in comparison with" prevailing market conditions for the goods in the country of provision, and thus no other comparison would do when private market prices exist.

The Appellate Body overruled the Panel, stating that the phrase "in relation to" implies a comparative exercise, but its meaning is not limited to "in comparison with". The phrase "in relation to" has a meaning similar to the phrases "as regards" and "with respect to". It held:

> "These phrases do not denote the rigid comparison suggested by the Panel, but may imply a broader sense of "relation, connection, reference". Thus, the use of the phrase "in relation to" in Article 14(d) suggests that, contrary to the Panel's understanding, the drafters did not intend to exclude any possibility of using as a benchmark something other than private prices in the market of the country of provision. This is not to say, however, that private prices in the market of provision may be disregarded. Rather, it must be demonstrated that, based on the facts of the case, the benchmark chosen relates or refers to, or is connected with, the conditions prevailing in the market of the country of provision." (Para 89)

3.10. <u>Article 14(d)</u> ("…prevailing market prices…country of provision")
(Are private prices required to be used in *every situation* for determining whether government has provided goods for less than adequate remuneration?)

In the dispute of *Softwood Lumber IV (AB)*, US appealed against the Panel's ruling that by rejecting private prices in Canada and using cross border prices from the US, the US Department of Commerce (DOC), had acted inconsistent with Article 14(d) of the *SCM Agreement*, especially since it had acknowledged the existence of private stumpage market

in Canada.

The Appellate Body concluded that the Panel's interpretation of Article 14(d) is "overly restrictive and based on an isolated reading of the text." In this regard, the Appellate Body stated, Members are obliged, under Article 14(d), to abide by the guideline for determining whether a government has provided goods for less than adequate remuneration. However, that guideline, it said, *did not* require the use of private prices in the market of the country of provision *in every situation*. Rather, that guideline required that the method selected for calculating the benefit must relate or refer to, or be connected with, the prevailing market conditions in the country of provision, and must reflect price, quality, availability, marketability, transportation and other conditions of purchase or sale, as required by Article 14(d). The Appellate Body thus ruled that the prices in the market of the country of provision are the primary, but not the exclusive, benchmark for calculating benefit. (Para 96 -97)

3.11. <u>Article 14(d)</u> ("…prevailing market conditions…country of provision")
(When may investigating authorities use a benchmark other than private prices in the country of provision?)

In the dispute of *Softwood Lumber IV (AB)*, the Appellate Body reversed the Panel's ruling which said that private prices in the country of provision must be the only benchmark for calculating benefit. The Panel had ruled that in an area of economic activity where there is no 'private market' a proxy market could be used for instance where the government was the only supplier of the good in the country or where the government administratively controlled all of the prices for the good in the country, there would be *no* price other than the price charged by the government and thus no basis for the comparison foreseen in Article 14(d) *SCM Agreement*. The Appellate Body took a much broader view than the Panel and added a third situation in which out of country prices could be used. It held that:

> "When private prices are distorted because the government's participation in the market as a provider of the same or similar goods is so predominant that private suppliers will align their prices with those of the government-provided goods, it will not be possible to calculate benefit having regard exclusively to such prices.
>
> We emphasize once again that the possibility under Article 14(d) for investigating authorities to consider a benchmark other than private prices in the country of provision is very limited. The determination of whether private prices are distorted because of the government's predominant role in the market, as a provider of certain goods, must be made on a case-by-case basis, according to the particular facts underlying each countervailing duty investigation." (Paras 100- 102)

3.12. <u>Article 14 (d)</u> ("prevailing market conditions")
(Scenario where in-country private price may be rejected)

In the dispute of *US – CVD China (AB)*, the Appellate Body ruled that in-country private prices may be rejected when they are too distorted due to predominant participation of the government as a supplier in the market. It is hence:

> "… price distortion that would allow an investigating authority to reject in-country private prices, not the fact that the government is the predominant supplier *per se*. There may be cases, however, where the government's role as a provider of goods is so predominant that price distortion is likely and other evidence carries only limited

weight. We emphasize, however, that price distortion must be established on a case-by-case basis and that an investigating authority cannot, based simply on a finding that the government is the predominant supplier of the relevant goods, refuse to consider evidence relating to factors other than government market share. " (Para 446)

3.13. Article 14(d) ("…adequacy of remuneration")
(What obligations must be followed in respect of the alternative benchmark?)

In the dispute of *Softwood Lumber IV (AB)*, the Appellate Body held that:

"…alternative methods for determining the adequacy of remuneration could include proxies that take into account prices for similar goods quoted on world markets, or proxies constructed on the basis of production costs. We emphasize, however, that where an investigating authority proceeds in this manner, it is under an obligation to ensure that the resulting benchmark relates or refers to, or is connected with, prevailing market conditions in the country of provision, and must reflect price, quality, availability, marketability, transportation and other conditions of purchase or sale, as required by Article 14(d)." (Para 106)

3.14. Article 14 ("benefit to the recipient")
(Benchmark in the guidelines for 'benefit')

In the dispute *Canada Aircraft* the Panel noted that "Article 14 provides guidelines for calculating "the benefit to the recipient conferred pursuant to paragraph 1 of Article 1." These guidelines employ a commercial benchmark, whereby a financial contribution "shall not be considered as conferring a benefit" unless that financial contribution is made on terms that are more advantageous than would have been available to the recipient on the commercial market."(Para 9.113)

3.15. Article 14 and Article 1.1(b) ("benefit")
(Can the commercial benchmarks applied for Article 14 be relevant for determining when on Article 1.1(b) benefit arises?)

In the dispute *Canada Aircraft*, the Panel was of the view that "Article 14 refers expressly to commercial benchmarks for identifying explicit situations in which an Article 1.1 "benefit" shall not arise. We see no reason why the commercial benchmarks applied in Article 14 for the purpose of determining when an Article 1.1 "benefit" does not arise should not serve as relevant context for determining when an Article 1.1 "benefit" does arise."(Para 9.113)

3.16. Article 14:
(Should the benefit be determined with reference to the market practice prevailing at the time contribution was bestowed?)

In the dispute *US Lead Bismuth*, US asserted that "benefit" should be determined by reference to the market practice prevailing at the time that each of the four types of "financial contribution" identified in that provision is bestowed.

The Panel did not share the United States' temporal interpretation of Article 14. According to the Panel "this interpretation is not consistent with the ordinary meaning of the text of that provision. Nothing in the text of Article 14 restricts the analysis envisaged in sub-paragraphs (a) - (d) of that provision to the time at which the relevant "financial

contribution" was bestowed. In our view, Article 14 simply does what it says it does: it provides guidelines to be respected by Members whenever they calculate "benefit". Those guidelines apply whether "benefit" is calculated at the time of bestowal, or at some subsequent time. Article 14 does not, therefore, guide Members as to when that calculation of "benefit" should take place." (Para 6.74)

4. PASS- THROUGH OF BENEFITS

4.1. Article 1.1 (b), Article 10, Footnote 36, GATT Article VI:3 (Pass-Through of benefits) (Whether an investigating authority is required to analyze that the subsidy conferred on products of certain enterprises in the production chain was 'passed through' in arm's length transactions?)

In the dispute of *Softwood Lumber IV (AB),* the appeal raised the issue whether the Panel erred in finding that US Department of Commerce's failure to conduct a 'pass-through' analysis in respect of arm's length sales of logs and lumber by tenured timber harvesters / sawmills to unrelated sawmills and lumber manufacturers was inconsistent with Article 10 and 32.1 of the *SCM Agreement* and Article VI:3 of the GATT 1994. The Appellate Body ruled that where the producer of the input is not the same entity as the producer of the processed product, it could not be presumed, however, that the subsidy bestowed on the input passes through to the processed product. In such case, it is necessary to analyze to what extent subsidies on inputs may be included in the determination of the total amount of subsidies bestowed upon processed products. For it is only the subsidies determined to have been granted upon the *processed products* that may be offset by levying countervailing duties on those products. (Para 140)

The Appellate Body further noted that:

> "… it would not be possible to determine whether countervailing duties levied on the processed product are in excess of the amount of the total subsidy accruing to that product, without establishing whether, and in what amount, subsidies bestowed on the producer of the input flowed through, downstream, to the producer of the product processed from that input. Because Article VI:3 permits offsetting, through countervailing duties, no more than the "subsidy determined to have been granted ... directly or indirectly, on the manufacture [or] production ... of such product", it follows that Members must not impose duties to offset an amount of the input subsidy that has not passed through to the countervailed processed products.
>
> The definition of "countervailing duties" in footnote 36 to Article 10 of the SCM Agreement supports this interpretation of the requirements of Article VI:3 of the GATT 1994. This interpretation is also borne out by the general definition of a "subsidy" in Article 1 of the SCM Agreement. According to that definition, a subsidy shall be deemed to exist only if there is both a financial contribution by a government within the meaning of Article 1.1(a)(1), and a benefit is thereby conferred within the meaning of Article 1.1(b).
>
> In the light of the above, GATT/WTO dispute settlement practice is consistent with and confirms our interpretation that, where countervailing duties are used to offset subsidies granted to producers of input products, while the duties are to be imposed on processed products, and where input producers and downstream processors operate at arm's length, the investigating authority must establish that the benefit conferred by a financial contribution directly on input producers is passed through, at least in part, to producers of the processed product subject to the investigation." (Paras 141-142, 146)

4.2. Article 1.1 (b) (Pass-Through of benefits) (Whether a pass-through analysis is required with respect to arm's length sales of *logs* by harvesters who own sawmills to unrelated sawmills for further processing?)

In the dispute of *Softwood Lumber IV (AB)*, the US argued that no pass-through analysis is required, because the tenured harvester / sawmill processes *some* logs into softwood *lumber* in its own sawmill and is thus the producer of the product subject to the investigation. The Appellate Body rejected US's argument and stated that:

> " …the United States acknowledges that a pass-through analysis is required where a tenured "independent" harvester, which does not own a sawmill and thus does not produce softwood lumber, sells logs at arm's length to unrelated sawmills. We do not see why the mere fact that a tenured harvester owns—or does not own—a sawmill, should affect whether a pass-through analysis is necessary with respect to logs sold at arm's length…. We agree, in the abstract, that a transfer of benefits from logs sold in arm's length transactions to lumber produced in-house from different logs *is possible* for a harvester that owns a sawmill. But whether, in fact, this occurs depends on the particular case under examination. In any event, these arm's length sales at issue concern logs, which are *not products* subject to the investigation. Accordingly, in cases where logs are sold by a harvester/sawmill in arm's length transactions to unrelated sawmills, it may not be assumed that benefits attaching to the logs (non-subject products) automatically pass through to the lumber (the subject product) produced by the harvester/sawmill. A pass-through analysis is thus required in such situations."
>
> Indeed, we disagree with the proposition that, as long as an enterprise produces products subject to an investigation, *any* benefits accruing to the same enterprise from subsidies conferred on any different products it produces (which are *not* subject to that investigation), could be included, without need of a pass-through analysis, in the total amount of subsidization found to exist for the investigated product, and that may be offset by levying countervailing duties on that product. We conclude that the pass-through of the benefit cannot be presumed with respect to arm's length sales of logs by harvesters, who own sawmills, to unrelated sawmills, for further processing. (Para 157)

4.3. Article 1.1 (b) (Pass-Through of benefits)

(Whether it is necessary to analyze whether benefits have been passed through from one product subject to the investigation (primary softwood lumber) to another product subject to that investigation (remanufactured softwood lumber)?)

In the dispute of *Softwood Lumber IV (AB)*, one of the issues before the Appellate Body concerned tenured timber harvesters that owned or were related to sawmills, processed the logs they harvested into softwood lumber, and sold lumber to unrelated re-manufacturers for further processing. The question that arose was whether a pass-through analysis is required in respect of these arm's length sales of softwood lumber.

The Appellate Body held:

> "In this situation, the products of both the harvesters/sawmills and the re-manufacturers are subject to the investigation.
>
> Once it has been established that benefits from subsidies received by producers of non-subject products (that is, inputs) have passed through to producers of subject products (primary and remanufactured softwood lumber), we do not see why a further pass-through analysis between producers of subject products should be required in an investigation conducted on an aggregate basis. In this situation, it is not necessary to calculate precisely how subsidy benefits are divided up between the producers of

subject products in order to calculate, on an aggregate basis, the total amount of subsidy and the country-wide countervailing duty rate for those subject products." (Paras 159 - 163)

4.4. <u>Article 1.1(b) and 14</u> (Pass – Through of benefits)

(Whether a pass-through analysis is required whenever there is any arms'-length transaction between unrelated companies in the chain of the production of an imported product subject to a countervail investigation, although the subsidy in question was a direct subsidy on producing the exported product?)

In the dispute of *Mexico – Olive Oil CVD*, the European Communities claimed that Mexico acted inconsistently with *SCM Agreement* Articles 1 and 14 by failing to calculate the benefit conferred on the recipient pursuant to paragraph 1 of Article 1 of the *SCM Agreement* and to apply the method used to each particular case in a transparent way which is adequately explained, in violation of Article 14 of the *SCM Agreement*. It argued that Mexico failed to conduct a 'pass-through' analysis to determine the extent to which any benefits received by olive growers for the production of olive oil were transmitted to the exporters of olive oil to Mexico. It also argued that a "pass-through" analysis was required because: (1) the oil obtained by simple crushing of the olives was an input into the product finally exported; and (2) the persons upon whom the countervailing measures were imposed (identified by the European Communities as the exporters) were not related to the initial recipients of the subsidy, the olive growers, and the product had been the subject of arms' length transactions while moving between them. The European Communities submitted that a "pass-through" analysis was required even when only the second of the two conditions is met, i.e., when the exporters of olive oil are not related to the olive growers who receive the subsidies. Mexico on the other hand argued that no pass-through analysis was necessary in the olive oil investigation. According to Mexico, the subsidy programme at issue was a direct subsidy on the production of the imported product, olive oil, and had been notified as such by the European Communities to the WTO Committee on Agriculture.

The Panel summarized the legal position on the issue and stated:

> "To summarize, the *US - Softwood Lumber IV* and *US – Canadian Pork* cases have established that a pass-through analysis is required in circumstances in which both of the following conditions are present: (1) a subsidy is provided in respect of a product that is an input into the processed, imported product that is the subject of the countervail investigation; and (2) the producer of the input product and the producer of the imported product subject to the countervail investigation are unrelated. This obligation to conduct a pass-through analysis arises under Article VI:3 of the GATT and Article 10 of the *SCM Agreement*. As the Appellate Body stated in *US - Softwood Lumber IV*, "because Article VI:3 permits offsetting, through countervailing duties, no more than the 'subsidy determined to have been granted ... on the manufacture [or] production ... of such product', it follows that Members must not impose duties to offset an amount of the input subsidy that has not passed through to the countervailed processed products."
>
> The *US - Softwood Lumber IV* and *US – Canadian Pork* jurisprudence does not support the European Communities' argument that whenever there is any arms'-length transaction between unrelated companies in the chain of the production of an imported product subject to a countervail investigation, a pass-through analysis must be conducted." (Paras 7.142 -143)

4.5. Article 1.1(b) and 14 (Pass – Through of benefits) (Can a "pass - through" claim be based solely on the basis of Articles 1 and 14 of the SCM Agreement?)

In the dispute of *Mexico – Olive Oil CVD*, where the European Communities claimed that Mexico acted inconsistently with *SCM Agreement* Articles 1 and 14 by failing to calculate the benefit and conduct a 'pass – through' analysis conferred on the recipient pursuant to paragraph 1 of Article 1 of the *SCM Agreement*, the Panel stated that:

> "For reasons not clear to us, and in spite of the fact that the legal bases for a "pass-through" obligation in the past jurisprudence were found in Article VI:3 of the GATT 1994 and Article 10 of the SCM Agreement, the European Communities has based its "pass-through" claims in this case solely on the basis of Articles 1 and 14 of the SCM Agreement. The European Communities' argument is that Mexico did not conduct a pass-through analysis, that it should have done so in the circumstances of this investigation, and that this failure was inconsistent with the "benefit" requirement of Article 1.1, because "the element of the definition of subsidy with which the notion of pass through is most closely linked is that of 'benefit'". The European Communities also cites Article 14 in the context of "benefit", stating that this provision addresses the calculation of benefit in terms of benefit to the recipient, and establishes that such calculation must be based on "commercial realities", which are the basis for the notion of pass-through." (Para 7.145)

With respect to Article 1, the Panel noted that that the EC allegation was that Mexico did not properly calculate the amount of the benefit from the subsidy that was directly attached to the exporters of olive oil. However, the Panel rejected this argument on the basis that Article 1.1 deals with whether a benefit "exists" and does not relate "to how the amount of the benefit is to be calculated in a countervail investigation." Therefore, the Panel found that Article 1.1(b) in itself does not establish a requirement to calculate precisely the amount of the benefit accruing to a particular recipient in a countervail investigation. (Paras 7.147 to 153).

With respect to Article 14, the Panel held that nothing in the Article requires a member to conduct a pass – through analysis and the European Communities had failed to show how calculation methodology either lacked transparency or was inadequately explained (Paras 7.159 – 7.167)

5. DOUBLE REMEDIES

5.1. Double Remedies (*SCM Agreement* Articles 10, 19.3, 19.4 and 32.4 and *GATT* Articles VI:3 and I:1)
(When can a double remedy occur?)

In the dispute of *US – CVD China (AB)*, the Appellate Body looked into China's claims in connection with the alleged imposition by the United States of "double remedies" resulting from the application, in each of the four sets of investigations at issue, of anti-dumping duties calculated under the United States' Non-Market Economy (NME) methodology simultaneously with countervailing duties on the same products. The Appellate Body explained how a double remedy occurs and stated:

> "When investigating authorities calculate a dumping margin in an anti-dumping investigation involving a product from an NME, they compare the export price to a normal value that is calculated based on surrogate costs or prices from a third country. Because prices and costs in the NME are considered unreliable, prices, or, more commonly, costs of production, in a market economy are used as the basis for calculating normal value. In the dumping margin calculation, investigating authorities compare the product's constructed normal value (not reflecting the amount of any subsidy received by the producer) with the product's actual export price (which, when subsidies have been received by the producer, is presumably lower than it would otherwise have been). The resulting dumping margin is thus based on an asymmetric comparison and is generally higher than would otherwise be the case.
>
> ….the dumping margin calculated under an NME methodology "reflects not only price discrimination by the investigated producer between the domestic and export markets ('dumping')", but also "economic distortions that affect the producer's costs of production", including specific subsidies to the investigated producer of the relevant product in respect of that product. An anti-dumping duty calculated based on an NME methodology may, therefore, "remedy" or "offset" a domestic subsidy, to the extent that such subsidy has contributed to a lowering of the export price. Put differently, the subsidization is "counted" within the overall dumping margin. When a countervailing duty is levied against the same imports, the same domestic subsidy is also "counted" in the calculation of the rate of subsidization and, therefore, the resulting countervailing duty offsets the same subsidy a second time. Accordingly, the concurrent imposition of an anti-dumping duty calculated based on an NME methodology, and a countervailing duty may result in a subsidy being offset more than once, that is, in a double remedy." (Paras 542 -543)

5.2. Double Remedies (*SCM Agreement* Articles 10, 19.3, 19.4 and 32.4 and *GATT* Articles VI:3 and I:1)
(Are double remedies permitted?)

On an analysis of several provisions of the *SCM Agreement* especially Article 19, the Appellate Body in the dispute of *US – CVD China (AB)* concluded that

> "… based on all of the above, we consider that the Panel erred in its interpretation of Article 19.3 of the SCM Agreement and failed to give meaning and effect to all the terms of that provision. Under Article 19.3 of the SCM Agreement, the appropriateness of the amount of countervailing duties cannot be determined without having regard to anti-dumping duties imposed on the same product to offset the same

subsidization. The amount of a countervailing duty cannot be "appropriate" in situations where that duty represents the full amount of the subsidy and where anti-dumping duties, calculated at least to some extent on the basis of the same subsidization, are imposed concurrently to remove the same injury to the domestic industry. Dumping margins calculated based on an NME methodology are, for the reasons explained above, likely to include some component that is attributable to subsidization.

We, therefore, reverse the Panel's interpretation of Article 19.3 and, in particular, its findings that "the imposition of anti-dumping duties calculated under an NME methodology has no impact on whether the amount of the concurrent countervailing duty collected is 'appropriate' or not", and *that Article 19.3 of the SCM Agreement does not address the issue of double remedies.* We find instead that the imposition of double remedies, that is, the offsetting of the same subsidization twice by the concurrent imposition of anti-dumping duties calculated on the basis of an NME methodology and countervailing duties, is inconsistent with Article 19.3 of the *SCM Agreement*." (Paras 582 - 583)

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