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UNITED STATES - TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Second recourse to Article 21.5 of the DSU
by the European Communities

Report of the Panel

TABLE OF CONTENTS

TABLE OF CASES CITED IN THIS REPORT

Short Title	Full Case Title and Citation
Australia – Salmon (Article 21.5 – Canada)	Panel Report, *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 of the DSU by Canada*, WT/DS18/RW, adopted 20 March 2000, DSR 2000:IV, 2031
Brazil – Desiccated Coconut	Appellate Body Report, *Brazil – Measures Affecting Desiccated Coconut*, WT/DS22/AB/R, adopted 20 March 1997, DSR 1997:I, 167
Canada – Aircraft (Article 21.5 – Brazil)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
EC – Bananas III	Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, DSR 1997:II, 591
EC – Bananas III (Article 21.5 – Ecuador)	Panel Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Article 21.5 of the DSU by Ecuador*, WT/DS27/RW/ECU, adopted 6 May 1999, DSR 1999:II, 803
EC – Bed Linen (Article 21.5 – India)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003
EC – Export Subsidies on Sugar	Appellate Body Report, *European Communities – Export Subsidies on Sugar*, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005
EC – Trademarks and Geographical Indications (US)	Panel Report, *European Communities – Protection of Trademarks and Geographical Indications for Agricultural Products and Foodstuffs, Complaint by the United States*, WT/DS174/R, adopted 20 April 2005
Guatemala – Cement I	Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767
Japan – Alcoholic Beverages II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97
Korea – Dairy	Appellate Body Report, *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000, DSR 2000:I, 3
Mexico – Corn Syrup (Article 21.5 – US)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
Thailand – H-Beams	Appellate Body Report, *Thailand – Anti-Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland*, WT/DS122/AB/R, adopted 5 April 2001, DSR 2001:VII, 2701
US – Carbon Steel	Appellate Body Report, *United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany*, WT/DS213/AB/R and Corr.1, adopted 19 December 2002, DSR 2002:IX, 3779

Short Title	Full Case Title and Citation
US – Corrosion-Resistant Steel Sunset Review	Appellate Body Report, *United States – Sunset Review of Anti-Dumping Duties on Corrosion-Resistant Carbon Steel Flat Products from Japan*, WT/DS244/AB/R, adopted 9 January 2004
US – Shrimp	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, adopted 6 November 1998, DSR 1998:VII, 2755
US – Shrimp (Article 21.5 – Malaysia)	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619 (Original Appellate Body Report")
US – FSC	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/R, adopted 20 March 2000, as modified by the Appellate Body Report, WT/DS108/AB/R, DSR 2000:IV, 1675 ("Original Panel Report")
US – FSC (Article 21.5 – EC)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55 ("Article 21.5 Appellate Body Report")
US – FSC (Article 21.5 – EC)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW, adopted 29 January 2002, as modified by the Appellate Body Report, WT/DS108/AB/RW, DSR 2002:I, 119 ("Article 21.5 Panel Report")

LIST OF ANNEXES

ANNEX A

FIRST SUBMISSIONS OF THE PARTIES

ANNEX B

SECOND SUBMISSIONS OF THE PARTIES

ANNEX C

THIRD PARTY SUBMISSIONS

ANNEX D

ORAL STATEMENTS, MEETING WITH THE PANEL

ANNEX E

REQUEST FOR THE ESTABLISHMENT
OF A PANEL

I. PROCEDURAL BACKGROUND

1.1 The original Panel and Appellate Body Reports in this dispute were adopted by the Dispute Settlement Body (the "DSB") on 20 March 2000. In its recommendations and rulings, the DSB requested the United States to bring the FSC measure that was found, in the Panel and Appellate Body Reports, to be inconsistent with its obligations under Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") and under Articles 10.1 and 8 of the *Agreement on Agriculture*, into conformity with its obligations under those Agreements.[1] Adopting the recommendation of the original Panel made under Article 4.7 of the *SCM Agreement*, the DSB specified that the prohibited FSC subsidies had to be withdrawn "at the latest with effect from 1 October 2000". On 12 October 2000, at a special session, the DSB agreed to the United States' request to allow it a time period expiring on 1 November 2000 to implement the DSB recommendations and rulings.[2]

1.2 On 15 November 2000, the United States enacted the "*FSC Repeal and Extraterritorial Income Exclusion Act of 2000*"[3] (the "ETI Act"). With the enactment of this legislation, the United States considered that it had implemented the DSB's recommendations and rulings in the dispute and that the legislation was consistent with the United States' WTO obligations.[4]

1.3 Following consultations requested by the European Communities on 17 November 2000, the DSB, acting under Article 21.5 of the *DSU*, referred the matter back to the original Panel on 20 December 2000. On 29 January 2002, the DSB adopted the Article 21.5 Panel and Appellate Body reports. The Article 21.5 Panel found the ETI Act to be inconsistent with Articles 3.1(a), 3.2 of the *SCM Agreement*, 10.1 and 8 of the *Agreement on Agriculture* and III:4 of the GATT 1994. It further found:

> "the United States has not fully withdrawn the FSC subsidies found to be prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement* and has therefore failed to implement the recommendations and rulings of the DSB made pursuant to Article 4.7 *SCM Agreement*."

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[1] Original Panel and Appellate Body Reports, *US – FSC*, para. 178. The original Panel concluded that the FSC scheme was inconsistent with the obligations of the United States under Article 3.1(a) of the *SCM Agreement* and under Articles 3.3 and 8 of the *Agreement on Agriculture*. The original Panel recommended at paras. 8.3-8.4:

> "With respect to our conclusions regarding the SCM Agreement, we *recommend*, pursuant to Article 4.7 of that Agreement, that the DSB request the United States to withdraw the FSC subsidies without delay." [i.e. by 1 October 2000 – see para. 8.8].
>
> "With respect to our conclusions regarding the Agreement on Agriculture, we *recommend* that the United States bring the FSC scheme into conformity with its obligations in respect of export subsidies under that Agreement....".

The Appellate Body upheld the Panel's *SCM Agreement* finding and modified the Panel's findings under the *Agreement on Agriculture* to find a violation of Articles 10.1 and 8. The original Appellate Body recommendation read:

> "The Appellate Body *recommends* that the DSB request the United States to bring the FSC measure that has been found, in this Report and in the Panel Report as modified by this Report, to be inconsistent with its obligations under Articles 3.1(a) and 3.2 of the *SCM Agreement* and under Articles 10.1 and 8 of the *Agreement on Agriculture*, into conformity with its obligations under those Agreements." (para. 178).

[2] See Minutes of the DSB meeting held on 12 October 2000, WT/DSB/M/90, paras. 6-7.

[3] United States Public Law 106-519, 114 Stat. 2423 (2000), Exhibit EC-2.

[4] Minutes of the DSB meeting held on 17 November 2000, WT/DSB/M/92, para. 143.

1.4 The 2002 Article 21.5 Panel Report contained no explicit new "withdrawal without delay" recommendation pursuant to Article 4.7 of the *SCM Agreement*, opining that the original DSB recommendation "remained operative".[5]

1.5 The Appellate Body upheld the 2002 Article 21.5 Panel's substantive findings (with modified reasoning). The 2002 Article 21.5 Appellate Body Report read, in part:

> "The Appellate Body *recommends* that the DSB request the United States to bring the ETI measure, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with its obligations under Article 3.1(a) of the *SCM Agreement*, under Articles 3.3, 8 and 10.1 of the *Agreement on Agriculture*, and under Article III:4 of the GATT 1994, into conformity with its obligations under those Agreements, and that the DSB request the United States to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."

1.6 On 22 October 2004, the United States enacted the "the American Jobs Creation Act of 2004" (the "Jobs Act").[6] The United States made the following statement in the DSB in November 2004:

> "...on 22 October 2004, President Bush had signed into law the American Jobs Creation Act of 2004 ("AJCA"). The AJCA had repealed the tax exclusion of the "FSC Repeal and Extraterritorial Income Exclusion Act of 2000" ("ETI Act"). It had thereby withdrawn the subsidy found to exist and brought the measure in question into conformity with US WTO obligations."[7]

1.7 On 5 November 2004, the European Communities requested consultations with the United States.[8] Consultations, held on 11 January 2005 in Geneva, did not lead to a satisfactory resolution of the matter.

1.8 On 14 January 2005, the European Communities requested the establishment of another Article 21.5 *DSU* Panel as there continued to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB between the United States and the European Communities, within the meaning of Article 21.5 of the *DSU*.[9] The European Communities made this request pursuant to Articles 6 and 21.5 of the *DSU*, Article 4 of the *SCM Agreement*, Article 19 of the *Agreement on Agriculture* and Article XXIII of the GATT 1994.

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[5] The interim review section of the 2002 Article 21.5 Panel Report, *US – FSC (Article 21.5 –EC)*, at para. 7.5, states:

> "The **European Communities** submits that it is not appropriate for us to make a recommendation in this case, as our mandate under Article 21.5 *DSU* is to decide a disagreement. In the EC view, this replaces the normal rule in Articles 7 and 11 *DSU* that a panel makes findings so as to assist the DSB in making recommendations and rulings. The European Communities argues that we have already made the recommendation referred to in Article 19 *DSU* in our original Report. The **Panel**, noting that the United States did not respond to this EC comment and that practice in this area has not been entirely consistent in Article 21.5 *DSU* proceedings[44], is of the view that the original recommendation adopted by the DSB on 20 March 2000 remains operative. We have therefore deleted what was originally paragraph 9.3 of the interim report (and made a consequential change in the title of Section IX of the Report)."

[44] Certain Article 21.5 *DSU* panels have made recommendations ... while others have not ....".

[6] Text of the Jobs Act is in Exhibit EC-1.

[7] WT/DSB/M/178, para. 38.

[8] The consultation request was circulated in document WT/DS108/27, dated 10 November 2004.

[9] The Panel request was circulated in document WT/DS108/29, dated 14 January 2005.

1.9 At its meeting on 17 February 2005, the DSB referred this dispute, if possible, to the original Panel in accordance with Article 21.5 of the *DSU* to examine the matter referred to the DSB by the European Communities in document WT/DS108/29. At that DSB meeting, it also was agreed that the Panel should have standard terms of reference, as follows:[10]

> "To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS108/29 the matter referred by the European Communities to the DSB in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.10 The Panel was composed on 2 May 2005 as follows:[11]

Chairman: Mr. Germain Denis

Members: Mr. Didier Chambovey
Professor Seung Wha Chang

1.11 Australia, Brazil and China reserved their rights to participate in the Panel proceedings as third parties.

1.12 The Panel met with the parties on 30 June-1 July 2005 and with third parties on 1 July 2005.

1.13 The Panel submitted its interim report to the parties on 22 July 2005. On 1 August 2005, both parties submitted written requests that the Panel review certain specific aspects of the interim report. On 5 August 2005, each party submitted written comments on the other party's written request. The Panel submitted its final report to the parties on 10 August 2005.

II. FACTUAL ASPECTS

A. INTRODUCTION

2.1 These proceedings of this Article 21.5 compliance panel follow the United States enactment of the Jobs Act in late 2004.

2.2 Before briefly describing the Jobs Act, we recall the relevant provisions of the original FSC and ETI subsidy measures.

B. THE ORIGINAL FSC SCHEME

2.3 A detailed description of the original FSC scheme was contained in paragraphs 2.1-2.8 of the original Panel Report.[12]

2.4 Briefly, Sections 921-927 of the US Internal Revenue Code provided for a US tax exemption on a portion of a FSC's earnings. This was "foreign trade income", the gross income of a FSC attributable to "foreign trading gross receipts". Foreign trading gross receipts meant the gross receipts of any FSC generated by qualifying transactions, which generally involved the sale or lease of certain

[10] See document WT/DS108/30.
[11] *Ibid.*
[12] Original Panel Report, *US – FSC*, paras. 2.1-2.8.

"export property".[13] A FSC had to meet certain requirements of foreign presence and foreign economic processes.[14]

2.5 A portion of the "foreign trade income" was deemed to be "foreign source income not effectively connected with a trade or business in the United States" and was therefore not taxed in the United States.[15] This untaxed portion was "exempt foreign trade income".[16] The remaining portion was taxable to the FSC. Dividends paid by the FSC out of exempt and non-exempt income to the shareholder (ordinarily, the "related supplier") generally qualified for a full dividends-received deduction.[17] Special rules applied for agricultural cooperatives.[18] The FSC scheme also contained certain income allocation (including two administrative pricing) rules in the case of a sale of export property to a FSC by a person described in Section 482 of the Internal Revenue Code (*i.e.*, by a related supplier). There were also certain requirements relating to distribution activities attributable to the export transaction.[19]

C. THE ETI ACT

2.6 A detailed description of the ETI Act was contained in paragraphs 2.2 to 2.8 of the 2002 Article 21.5 Panel Report.[20]

2.7 Briefly, the ETI Act consisted of five sections. Aspects of sections 2, 3 and 5 are most relevant.[21]

2.8 Section 3, entitled "Treatment of Extraterritorial Income", amended the Internal Revenue Code by inserting a new section 114, as well as a new Subpart E, which was in turn composed of new sections 941, 942 and 943. The ETI Act permitted certain US and foreign taxpayers to elect to have qualifying income taxed in accordance with the ETI provisions on a transaction-by-transaction basis.

2.9 Subject to certain exceptions, income from specific transactions would qualify for ETI fiscal treatment if it was attributable to "foreign trading gross receipts":[22] (i) from specific types of

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[13] With certain exceptions, export property is:

- property held for sale or lease;
- manufactured, produced, grown, or extracted in the United States;
- by a person other than a FSC;
- sold, leased, or rented for use, consumption, or disposition outside the United States; and
- with no more than 50 per cent of its fair market value attributable to imports."

[14] Section 922(a) and Section 924(b) of the Internal Revenue Code.

[15] Such income is generally exempt from tax under section 882 of the Internal Revenue Code, if it is earned by a corporation resident outside the United States.

[16] See Section 923(a) of the Internal Revenue Code.

[17] Section 926(a) and 245(c) Internal Revenue Code.

[18] See Section 923(a)(4) and Section 245(c)(2)(B) of the Internal Revenue Code.

[19] See Section 925(c) and Section 924 (d) and (e) of the Internal Revenue Code.

[20] 2002 Article 21.5 Panel Report, *US – FSC (Article 21.5 – EC)*.

[21] The remaining provisions of the ETI Act consist of section 1 containing the short title of the ETI Act and section 4 which sets forth a number of "technical and conforming" amendments.

[22] Section 942(a) of the Internal Revenue Code designated as "foreign trading gross receipts" the receipts generated in transactions satisfying all three of these conditions. Under section 114(e) of the Internal Revenue Code, "extraterritorial income" was the gross income attributable to foreign trading gross receipts and, under section 941(b) of the Internal Revenue Code, "foreign trade income" was the taxable income attributable to foreign trading gross receipts.

transactions;[23] (ii) involving "qualifying foreign trade property";[24] and (iii) if the "foreign economic process requirement" was fulfilled.[25]

2.10 Section 114(a) of the Internal Revenue Code provided that a taxpayer's gross income "does not include extraterritorial income". Section 114(b) added that this exclusion of extraterritorial income from gross income "shall not apply" to that portion of extraterritorial income which is not "qualifying foreign trade income". Accordingly, the portion of extraterritorial income which was excluded from gross income – and, thereby, from United States taxation – was an amount which would result in a reduction of the taxable income of the taxpayer from the qualifying transaction.[26]

2.11 Section 2 of the ETI Act repealed the provisions of the Internal Revenue Code relating to FSCs.[27] Section 5(b) prohibited foreign corporations from electing to be treated as FSCs after 30 September 2000 and provided for the termination of inactive FSCs.

2.12 However, section 5(c) created a “transition period” and a “grandfathering clause” for certain transactions of existing FSCs. Specifically, section 5(c)(1) of the ETI Act stipulated that the repeal of the provisions of the Internal Revenue Code relating to FSCs "shall not apply" to transactions of existing FSCs which occur before 1 January 2002 or to any other transactions of such FSCs which occur after 31 December 2001, pursuant to a binding contract between the FSCs and an unrelated person which is in effect on 30 September 2000.

D. THE JOBS ACT

2.13 The Jobs Act applied from 1 January 2005 (section 101(c) of the Jobs Act). Thus, the ETI scheme continued until the end of 2004.

2.14 Section 101 of the Jobs Act is entitled "Repeal of exclusion for extraterritorial income". Section 101(a) of the Jobs Act stipulates: "Section 114 [of the Internal Revenue Code] is hereby repealed." Section 101(b), entitled "conforming amendments", provides, in its sub-paragraph (1): “Subpart E of Part III of subchapter N of chapter 1 (relating to qualifying foreign trade income) is hereby repealed".[28]

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[23]Foreign trading gross receipts could be earned through (i) any sale, exchange, or other disposition of qualifying foreign trade property; (ii) any lease or rental of qualifying foreign trade property; (iii) any services which are related and subsidiary to (i) and (ii); (iv) for engineering or architectural services for construction projects located (or proposed for location) outside the United States; and (v) for the performance of managerial services for a person other than a related person in furtherance of activities under (i), (ii) or (iii). (section 3 of the ETI Act, section 942(a) of the Internal Revenue Code).

[24] Qualifying foreign trade property was property: (A) manufactured, produced, grown or extracted within or outside the United States; (B) held primarily for sale, lease or rental, in the ordinary course of business, for direct use, consumption, or disposition outside the United States; and (C) not more than 50 per cent of the fair market value of which is attributable to: (i) articles manufactured, produced, grown, or extracted outside the United States; and (ii) direct costs for labour performed outside the United States. Section 3 of the ETI Act, section 943(a)(1) of the Internal Revenue Code. Section 943(a)(3) and (4) of the Internal Revenue Code set forth specific exclusions from this general definition.

[25] Section 3 of the ETI Act, section 942(b), (b)(2)(A)(ii), (b)(2)(B) and (b)(3) of the Internal Revenue Code.

[26] Pursuant to section 941(a)(1) and (2) of the Internal Revenue Code, qualifying foreign trade income would be calculated as the greatest of, or the taxpayer's choice of, the following three options: (i) 30 per cent of the foreign sale and leasing income derived by the taxpayer from such transaction; (ii) 1.2 per cent of the foreign trading gross receipts derived by the taxpayer from the transaction; or (iii) 15 per cent of the foreign trade income derived by the taxpayer from the transaction.

[27]Subpart C of part III of Subchapter N of chapter 1, consisting of sections 921-927 of the Internal Revenue Code.

[28] Section 101(b)(2) also contains other “conforming amendments”, Exhibit EC-1.

2.15 However, pursuant to the "transition provision" in section 101(d) of the Jobs Act, for certain transactions in the period between 1 January 2005 and 31 December 2006, the ETI scheme remains available on a reduced basis. That is, a percentage of ETI benefits remain available in respect of each qualifying transaction (80 per cent in 2005 and 60 per cent in 2006).

2.16 In addition to that time-limited transition provision, section 101(f) of the Jobs Act indefinitely grandfathers the ETI scheme in respect of certain transactions.[29]

2.17 Moreover, Section 101 of the Jobs Act does not repeal section 5(c)(1) of the ETI Act, indefinitely grandfathering FSC subsidies in respect of certain transactions.[30] Nothing in the legislative language of the Jobs Act modifies, explicitly or implicitly, the transition rules for the FSC subsidies.[31]

III. REQUESTS BY THE PARTIES

3.1 In its request for establishment of the Panel, the European Communities asks the Panel to find:

> "– that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*.
>
> – that the United States continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994."[32]

3.2 In response to Panel questioning, the European Communities clarified that it "is not seeking repetition of" the findings, recommendations and rulings "already made in previous Reports and by the DSB in this dispute".[33] Rather, the European Communities seeks a finding that by promulgating the Jobs Act, "the United States has not fully complied with the findings and recommendations made by the Panel and the Appellate Body in the original proceeding and in the Article 21.5 proceeding, as adopted by the DSB."[34] The European Communities also clarified that we might legitimately exercise judicial economy with respect to the "claims" of the European Communities under Articles 19.1 and 21.1 of the *DSU*.[35]

3.3 The United States requests that "the Panel reject the EC claims".[36]

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[29] The amendments made by section 101 of the Jobs Act do not apply to any transaction in the ordinary course of a trade or business which occurs pursuant to a binding contract (1) which is between the taxpayer and an unrelated person, and (2) which was already in effect on 17 September 2003 (the last day prior to the introduction of the bill before the US Senate) and at all times thereafter.

[30] See, for example, US response to Panel Question 1.

[31] See, for example, US response to Panel Question 2.

[32] WT/DS108/29.

[33] See EC response to Panel Question 8. Although the European Communities, in its first written submission, requested that we make a further recommendation, it subsequently asserted that such a further recommendation was not necessary. According to the European Communities: "The Panel can confirm that [the] Article 4.7 recommendation made in the original proceedings remains operative and unsatisfied". See EC response to Panel Questions 8, 27 and 28.

[34] See EC response to Panel Question 8.

[35] See EC response to Panel Question 10.

[36] US first written submission, para. 21.

IV. ARGUMENTS OF THE PARTIES

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

V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of the third parties -- Australia, Brazil and China -- are set out in their submissions to the Panel and are attached to this Report as Annexes (see List of Annexes, page iv).

VI. INTERIM REVIEW

6.1 The Panel submitted its interim report to the parties on 22 July 2005. On 1 August 2005, both parties submitted written requests that the Panel review certain specific aspects of the interim report. On 5 August 2005, each party submitted written comments on the other party's written request.

A. COMMENTS BY THE EUROPEAN COMMUNITIES

6.2 The **European Communities** requested changes in the terminology or formatting in paragraphs 1.4, 7.35, 7.37 (footnote 65), 7.43 and 7.47.

6.3 The **United States** submitted no comments in respect of the EC comments on paragraphs 1.4 and 7.37.

6.4 However, in respect of paragraph 7.35, the United States asserts that the EC's suggested textual changes are designed to equate the "findings" of a panel with the "rulings" of the Dispute Settlement Body ("DSB"). Indeed, this same assumption appears to underlie the Panel's draft of paragraph 7.35. In the view of the United States, however, "findings" are distinct from both "recommendations" and "rulings". According to the United States, the EC's proposed approach is contradicted by the text of the *DSU* (*e.g.* Articles 7.1 and 11). At the same time, the United States agrees with the essence of the paragraph, that is, that a panel or Appellate Body recommendation only has effect when adopted by the DSB. The third sentence of this paragraph raises the question of how the recommendations in a single report could "meld" into DSB recommendations. This may have been meant to refer to the effect of an Appellate Body report on a panel report where the panel report may be modified. Furthermore, in reviewing the EC comments, the United States noted that the first sentence of paragraph 7.35 refers to "object and purpose considerations" but the remainder of the paragraph does not address "object and purpose." This first sentence would appear unnecessary and, to avoid confusion, may better be deleted. Accordingly, the United States would agree with the EC that paragraph 7.35 should be revised for greater accuracy, but the United States does not agree with the EC's proposed revisions and offers one of its own.

6.5 In respect of paragraph 7.43, the United States asserts that the first change suggested by the EC highlights the fact that the interim report has created the notion of "rulings" under Article 19 of the DSU. Article 19, however, does not use that term. Accordingly, the United States requests that the third sentence of paragraph 7.41 be revised to delete "and rulings". The United States recalls that the second change suggested by the EC regarding this paragraph would be to italicize the word "requirement" in line 5. The United States opposes this change, because it would suggest that an Article 21.5 panel would have the discretionary authority to make new recommendations. As previously explained by the United States, an Article 21.5 panel does not have the mandate to make recommendations.

6.6 With respect to paragraph 7.47, the United States disagrees with the EC proposal to add, at the end of the first sentence, the following phrase: "and the relevant recommendations and rulings." The United States asserts that this would be inconsistent with the text of Article 21.5 of the *DSU*,

which says nothing about consistency with "the relevant recommendations and rulings." DSB recommendations and rulings are themselves required to be consistent with the covered agreements. DSB recommendations and rulings do not – indeed cannot – amend the covered agreements nor can they "add to or diminish" the rights and obligations under the covered agreements. Accordingly, the question of "consistency" remains a question of consistency with the covered agreements, not with recommendations and rulings.

6.7 In considering the parties' comments, the **Panel** has remained mindful that: Article 19.1 of the *DSU* states that a panel "shall recommend"; Article 4.7 of the *SCM Agreement* states that "the panel shall recommend..."; and a panel report must be adopted by the DSB to produce operative DSB rulings and recommendations. We have made certain changes in paragraphs 1.4 and 7.43. For greater clarity, and noting that we address the issue of whether Article 21.5 *requires* a new *recommendation*, we have made certain changes in paragraph 7.35 and in paragraph 7.37 (footnote 65). Mindful of the text of Article 21.5 of the *DSU*, and observing that the covered agreements also subsume, and govern, recommendations and rulings, we declined to alter paragraph 7.47.

6.8 In line with the **European Communities**' request, and noting that the **United States** made no reply, **we** have also supplemented the references to the relevant Panel and Appellate Body reports in paragraphs 7.56 (footnotes 75 and 76) and 7.60 and footnote 79.

B. COMMENTS BY THE UNITED STATES

6.9 The **United States** requests changes in footnote 29. The **European Communities** agrees. **We** have made changes in that footnote to reflect more accurately the text of section 101(f) of the Jobs Act.

6.10 Taking note of the **United States** statement that it never argued that *de minimis* adverse effects are relevant to the required withdrawal of a prohibited subsidy, and noting the **European Communities** suggestion that the United States does not argue that they are, **we** have deleted what was footnote 73 of the interim report.

6.11 According to the **United States**, in paragraphs 7.42 and 7.46, the Panel refers to the "object and purpose" of various provisions of the *DSU* and the *SCM Agreement*. The United States asserts that this appears to reflect an incorrect application of customary rules of interpretation of public international law. Article 31(1) of the *Vienna Convention on the Law of Treaties*, which is generally regarded as reflecting such rules, provides that a treaty is to be "interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of *its* object and purpose" (emphasis added). Thus, according to the United States, it is the object and purpose of the *treaty* that is to be considered. The **European Communities** suggests that we could take into account the US comments by referring to the object and purpose of the *DSU*, which includes the prompt and effective resolution of disputes.

6.12 The **Panel** is well aware of the principles of treaty interpretation cited by the United States, which are already cited in paragraph 7.21 of this Panel Report and which have, indeed, guided the Panel's examination. In respect of object and purpose of treaty terms, we recall the following statement of the Appellate Body in *US-Shrimp*:

> "A treaty interpreter must begin with, and focus upon, the text of the particular provision to be interpreted. It is *in the words constituting that provision, read in their context, that the object and purpose of the states parties to the treaty* must first be sought. Where the meaning imparted by the text itself is equivocal or inconclusive, or where confirmation of the correctness of the reading of the text itself is desired, light

from the *object and purpose of the treaty as a whole* may usefully be sought."[37] (emphasis added)

6.13 We believe that Article 3.2 of the *DSU* articulates a fundamental tenet relating to the object and purpose of the *DSU*, including its special and additional provisions, such as Article 4.7 of the *SCM Agreement*: "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system." The *DSU* aims to achieve the fair, prompt and effective resolution of trade disputes.[38] In respect of our interpretation of the terms of the *SCM Agreement*, we further recall and endorse the view of the 2002 Article 21.5 Panel that we must avoid an interpretation that "... 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." (para. 8.39) In our view, our interpretation of the text of the relevant treaty provisions, in their context, is reflective of their object and purpose. Moreover, this interpretation is entirely consistent with, reflective of, and confirmed by, the object and purpose of the *DSU* (and the *SCM Agreement*), as a whole. We have slightly altered paragraphs 7.42 and 7.46, by, among other things, inserting footnotes 66 and 69.

6.14 The **United States** asserts that the European Communities made three primary claims in this proceeding: under Article 4.7 of the *SCM Agreement* and Articles 19.1 and 21.1 of the *DSU*. The EC also made some "consequential" claims that flowed from the supposed breaches of these three articles. According to the United States, none of these three articles appropriately serves as the basis for claims in this proceeding. As a result, those primary claims fail and, because they are "consequential," the EC's consequential claims fail as well. According to the United States, the US arguments need to be viewed in this context, but the interim report does not appear to reflect this. For example, continues the United States, paragraph 7.37 misstates the US argument and makes it broader than it is. The US argument is that the EC erred in claiming that the United States had breached Article 4.7 of the *SCM Agreement* with respect to the ETI Act. There was no Article 4.7 recommendation, nor, for the reasons found by the Panel, would it have been appropriate for there to have been one. The United States asserts that paragraph 7.51 similarly misstates the US argument. The United States was not taking a position in the abstract regarding Members' obligations under the *SCM Agreement* (indeed, even aside from the question of whether a party could ever ask a panel to undertake such a discussion, given the terms of reference for this proceeding, that issue is not one that the Panel needs to undertake), but rather was responding to the EC claim of a breach of Article 4.7. For the reasons set forth in the US submissions, including the fact that Article 4.7 is not directed to Members but rather to panels, the US asserts that the EC failed to meet its burden of proving a breach of Article 4.7. The United States requests that the interim report, including these paragraphs, be modified accordingly. For example, the US asserts, the first sentence of paragraph 7.37 would more accurately read: "Before us, the United States asserts that in order for the EC to establish a breach of Article 4.7 of the SCM Agreement, the EC would first need to establish that there was a recommendation under Article 4.7 that the United States withdraw the ETI Act." Similarly, the US asserts, paragraph 7.51 would more accurately read: "We recall the United States argument that, in order for the EC to establish a breach of Article 4.7 of the SCM Agreement the EC would first need to establish the existence of a recommendation under Article 4.7 of the SCM Agreement that the United States withdraw the ETI Act." According to the United States, footnotes 65 and 74 also reflect the same misunderstanding, and the United States requests that they be deleted. In particular, footnote 65 ascribes an argument to the United States that the United States did not make, in that the issue was not presented to this Panel in the abstract of what obligations attach in the event a Member were to adopt a new prohibited subsidy, and the United States did not opine on that issue.

6.15 According to the **European Communities**, the United States draws an unwarranted distinction between the different EC claims in this proceeding, which in the US view are "primary" or

[37] Appellate Body Report, *US-Shrimp*, para. 114.
[38] See, for example, Original Appellate Body Report, *US – FSC*, para. 166.

"consequential". The United States does not further clarify what would be in its view the "consequential" claims of the European Communities. Given that the United States designates as "primary" the claims relating to Article 4.7 of the *SCM Agreement* and to Articles 19.1 and 21.1 of the *DSU*, the European Communities infers that the "consequential claims" would be the other claims contained in its request for establishment of a panel. According to the European Communities, this would however be a gross misrepresentation of the European Communities' position (and one that the United States is making for the first time). There is no basis in the European Communities' request for the establishment of the Panel for this contention by the United States. The European Communities asserts that the word "consequential" is put by the United States in quotation marks but with no indication of from where it is quoted. And for good reason because the claims of violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the *GATT 1994* were never described as "consequential" to any others. They are a consequence of the US having failed to withdraw the prohibited subsidies – not of the violations of Article 4.7 of the *SCM Agreement* or Articles 19.1 and 21.1 of the *DSU.*

6.16 The European Communities asserts that each claim listed in the EC request for establishment of the panel in this proceeding has its own merit and is grounded in a self-standing provision of the WTO.[39] In particular, the claims based on provisions other than Articles 4.7 of the *SCM Agreement* and 19.1 and 21.1 of the *DSU* are claims that the United States continues to violate certain WTO provisions because the measures found to be in violation of those provisions have not been fully removed or brought into compliance. As for the Panel's summary of the US argument in para. 7.37, the European Communities notes that it is very close to the title of section III.A of the US first written submission, reading:

> "A. In the Absence of Any Recommendation of Withdrawal under Article 4.7, this Panel Cannot Find that the United States Has Failed to Withdraw Its Prohibited Subsidies Within the Meaning of Article 4.7 of the SCM Agreement"

6.17 The European Communities asserts that it is also very close to the first part of paragraph 19 of the US first written submission, reading:

> "Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion."

6.18 The European Communities asserts that, as for paragraph 7.51, the Panel does not seem to attribute to the United States a position "in the abstract", but rather in respect of the present dispute. The European Communities further notes that neither the distinction between "primary" and "consequential" claims, nor the alternative formulations suggested by the United States for paras. 7.37 and 7.51 of the Interim Report appear to find correspondence in the submissions of the United States, unlike the current drafting of the said two paragraphs. The United States has referred to no passage of its own submissions where the points it makes in its comments would be reflected. Accordingly, should the Panel consider that some modifications of paras. 7.37 and/or 7.51 are in order, the European Communities respectfully submits that they should be limited to adding references to, e.g., paragraph 19 of the US first written submission.

6.19 **We** are confident that our original formulations of the US arguments were faithful to the arguments of the United States as articulated, *inter alia*, in its first written submission[40] and its oral

[39] [Footnote reference not used.]

[40] In its first written submission, para. 2, the United States asserted:

statement.[41] We note that the United States did not specifically identify any perceived inaccuracy in our description of its arguments in Section VII.B.2 of this Report. We have nevertheless clarified the US arguments in paragraphs 7.37 - 7.39 and 7.51 for greater certainty. To the extent that the United States is suggesting that it is not possible to establish a Member's breach of Article 4.7 (which, according to the United States, is not directed to Members but rather to panels), we recall that an issue before us is whether there is an operative DSB recommendation that the United States withdraw the prohibited subsidy. A key point for us is that the operative recommendations and rulings are those flowing from the original proceedings; these remained operative through the 2002 compliance proceedings. Arising therefrom is an operative DSB recommendation, rooted in Article 4.7 of the *SCM Agreement*, that the United States withdraw the prohibited ETI subsidies. For the reasons we have given, we find that the US has not yet fully done so.

6.20 We declined, however, to make the requested deletions of footnotes 65 and 74. In our view, these footnotes accurately depict a logical extension of the United States argument. While that hypothetical scenario is not before us, we nevertheless believe it serves as a useful aid in analyzing the merits of the United States argument.

6.21 To eliminate *any* possibility that paragraph 7.47 could, as suggested by the **United States**, be misread as implying that the task of the Panel is to be determined without regard to its terms of reference, and noting no disagreement on the part of the **European Communities**, **we** have inserted footnote 71, cross-referencing earlier footnotes 47 and 48.

6.22 The **United States** asserts that, in footnote 77, we appear to "conflate" the two standards under Article 21.5 of the *DSU* of "existence" and "consistency". According to the United States, the question of whether a measure "exists" is distinct from the question of whether a measure that does exist is "consistent with" a covered agreement. Given that, in the United States' view, the two standards clearly are different, the United States requests that this footnote be deleted. The **European**

"...the transition provisions of the AJCA are not inconsistent with Article 4.7 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") because, in the prior proceeding under Article 4 of the SCM Agreement and Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), there was no recommendation or ruling, pursuant to Article 4.7, by the Dispute Settlement Body ("DSB") that the ETI Act tax exclusion should be withdrawn. Thus, while the United States has repealed the ETI Act tax exclusion, in the absence of any recommendation or ruling of withdrawal under Article 4.7, this Panel cannot find that the United States has failed to comply with a DSB recommendation or ruling to withdraw its prohibited subsidies within the meaning of Article 4.7 of the SCM Agreement."

At para. 19 of its first written submission, the United States asserted:

"Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion....Furthermore, there is no basis for an Article 21.5 panel to make a finding of compliance or noncompliance with a DSB recommendation or ruling under Article 4.7 of the SCM Agreement in this dispute, and thus the Panel should reject the EC's claims under Article 4.7 of the SCM Agreement."

[41] See United States oral statement at Panel meeting, para. 5:

"...the EC's claim that the transition provisions of the AJCA are inconsistent with Article 4.7 is premised on the notion that the ETI Act tax exclusion was found to be inconsistent with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies. The US response to this claim is straightforward: no such finding was ever made, nor did the DSB make a recommendation under Article 4.7 that the ETI Act tax exclusion be withdrawn."

Communities disagrees that there is necessarily a difference in standards between "existence" and "consistency" of a measure taken to comply. According to the European Communities, in the case of partial compliance such as exists in this case the situation can be described as inconsistency or partial non-existence of the measure taken to comply. Where, as in the present case, a measure "taken to comply" has been adopted and the measure achieves partial compliance, there is a measure taken to comply for the part for which compliance is achieved; for the remainder, there is no measure. For the European Communities, there is no reason why the formulation that is chosen to describe the situation (non-existence or inconsistency) should lead to a difference in outcome. **We** have made certain changes in footnote 77 to better reflect our view.

6.23 In response to the **United States** request that we clarify the "alternative" to which we referred in paragraph 7.69, and noting the **European Communities** suggestion that this is, in fact, "in addition" rather than "in the alternative", **we** have modified that paragraph.

6.24 The **United States** submits that the second sentence of paragraph 7.80 is inaccurate in describing the scope of section 101 of the Jobs Act. The **European Communities** suggests a certain re-formulation of this paragraph. **We** have made clarifying changes in paragraph 7.80.

VII. FINDINGS

A. INTRODUCTION

7.1 This is the second time that the European Communities has asked a Panel to rule on the WTO-consistency of measures taken by the United States to comply with DSB recommendations and rulings in this dispute.

7.2 The original WTO dispute settlement proceedings resulted in DSB recommendations and rulings, in 2000, that the United States withdraw the prohibited FSC subsidies and bring itself into conformity with its obligations under the relevant covered agreements. The time period for withdrawal of the prohibited subsidies pursuant to Article 4.7 of the *SCM Agreement* expired on 1 November 2000.

7.3 Subsequently, the 2002 Article 21.5 *DSU* compliance proceedings established that the ETI Act[42] had failed to withdraw completely the prohibited FSC subsidy and to bring the United States fully into conformity with its WTO obligations.

7.4 Since that time, the United States has enacted the Jobs Act.[43]

7.5 We now turn to the parties' main claims and arguments before this Article 21.5 *DSU* compliance Panel.

B. ARGUMENTS OF THE PARTIES

1. European Communities

7.6 Before this Article 21.5 compliance Panel, the European Communities asserts that two provisions of the Jobs Act continue inconsistencies with the United States' WTO obligations. These two provisions are:

- the "transition provision"[44], which provides for a two-year continuation of a percentage of ETI benefits (80 per cent in 2005 and 60 per cent in 2006); and

[42] Text of the ETI Act is in Exhibit EC-2.
[43] Text of the Jobs Act is in Exhibit EC-1.

- the "grandfathering provision"[45], which exempts certain transactions indefinitely from the repeal of the ETI scheme.

7.7 Moreover, the European Communities submits that, as the Jobs Act is silent as to the prohibited FSC subsidies grandfathered through section 5 of the ETI Act, the United States persists in failing to withdraw fully these prohibited subsidies.

7.8 According to the European Communities, by not entirely withdrawing FSC and ETI subsidies, the United States has failed to implement the DSB recommendations and rulings of March 2000 and January 2002 and is in violation of Article 4.7 of the *SCM Agreement* and Articles 19.1 and 21.1 of the *DSU*. The European Communities argues that the violations of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994 persist.

7.9 The European Communities asserts that the United States has sought to reduce unduly the content of the Panel's terms of reference as set out in the EC Panel request. When read as a whole, the EC Panel request contains a clear reference to the original recommendation under Article 4.7 of the *SCM Agreement* and to the findings in the 2002 Article 21.5 proceedings (including with respect to the FSC grandfathering provisions in section 5 of the ETI Act).

2. United States

7.10 According to the United States, the purpose of fiscal transition provisions contained in sections 101(d) and (f) of the Jobs Act is to provide a smooth and orderly transition in order to prevent the repeal of tax legislation from having a retroactive effect on taxpayers who entered into arrangements in reliance on pre-repeal law. Such transition rules are typically included in major US tax legislation.

7.11 The United States does not directly contest the substantive arguments of the European Communities stated *supra*, paras. 7.6-7.9. Rather, the United States makes the following arguments:

- there is no recommendation or ruling under Article 4.7 of the *SCM Agreement* resulting from the 2002 Article 21.5 compliance proceedings to withdraw the ETI subsidy "without delay". The Appellate Body recommendations in the 2002 compliance proceeding relating to Article 4.7 do not pertain to the ETI Act, as the Appellate Body in the 2002 compliance report referenced the recommendations and rulings in the original proceedings, which were made *before* the ETI Act tax exclusion even existed. Consequently, the United States has not failed to comply with the DSB's recommendations and rulings, and the transition provisions of the Jobs Act are not inconsistent with Article 4.7 of the *SCM Agreement*; and

- this Panel's terms of reference do not include section 5 of the ETI Act, indefinitely grandfathering original FSC subsidies for certain transactions. The measures before the Panel are sections 101(d) and (f) of the Jobs Act, concerning the ETI Act tax exclusion, and the EC Panel request does not refer to any other provision of the Jobs Act. While the European Communities makes references in its first written submission to section 5 of the ETI Act, section 5 is not mentioned in the EC Panel request, and, thus, is not within the Panel's terms of reference.

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[44] Section 101(d) of the Jobs Act.
[45] Section 101(f) of the Jobs Act.

C. ARGUMENTS OF THE THIRD PARTIES

1. Australia

7.12 **Australia** submits that the pertinent Article 21.5 of the *DSU* "recommendations and rulings" are those made by the original Panel and Appellate Body, as adopted by the DSB in 2000. Hence, the purpose of the current Article 21.5 proceeding is to decide whether certain measures that the United States has taken to comply with these recommendations and rulings are consistent with the covered agreements.

7.13 According to Australia, the United States does not contest that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are measures taken to comply with the DSB's original recommendations and rulings. Under those circumstances, the measures at issue come within the mandate of an Article 21.5 proceeding.

7.14 Australia asserts that, given the absence of any substantive defence from the United States, the Panel should uphold the EC's arguments that the grandfathering of the FSC scheme and the transition and grandfathering provisions of the ETI scheme are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994. The obligation to withdraw the ETI scheme arises from the fact that the 2002 Article 21.5 Panel and Appellate Body Reports, as adopted by the DSB, found that the ETI scheme violated the covered agreements.

7.15 With respect to the Panel's terms of reference, Australia notes that section 5 of the *ETI Act* sets up, amongst other things, the grandfathering of the FSC scheme. The 2002 Article 21.5 Panel and Appellate Body Reports have already found this grandfathering to be a violation of the covered agreements. Australia also notes that it is section 101 of the Jobs Act that fails to repeal section 5 of the *ETI Act*. The former section was mentioned in the EC's Panel request.

2. Brazil

7.16 Citing Articles 3.3, 3.7, 21.1 and 21.3 of the *DSU*, **Brazil** asserts that prompt compliance and immediate withdrawal of WTO-inconsistent measures are core principles of WTO dispute settlement. The *SCM Agreement* (particularly Article 4.7) is even more stringent than the *DSU*.

7.17 According to Brazil, the transition and "grandfathering" provisions in the Jobs Act are an extension of a non-compliance situation. The United States attempts erroneously to split into two completely separate cases a situation where the facts and circumstances show that the cases are part of one same continuum (FSC – ETI – Jobs Act). Both the ETI Act and, now, the Jobs Act are measures taken to comply with the DSB's rulings and recommendations concerning the original proceedings.

3. China

7.18 Recalling the terms of Article 4.7 of the *SCM Agreement*, **China** submits that the obligation to withdraw prohibited subsidies without delay is not released simply because the 2002 compliance Panel did not specify a time-period in its conclusion. According to China, the party concerned failed to fully implement the DSB recommendations and rulings by introducing the transition period and grandfathering provisions for the FSC scheme, an export subsidy measure.

7.19 China also submits that a Member's obligation under Article 4.7 of *the SCM Agreement* to withdraw prohibited subsidies "without delay" is unaffected by contractual obligations that the Member itself may have assumed under municipal law. Likewise, a Member's obligation to withdraw prohibited export subsidies, under Article 4.7 of *the SCM Agreement*, cannot be affected by contractual obligations which private parties may have assumed *inter se* in reliance on laws

conferring prohibited export subsidies. China questions how transition period and grandfathering provisions for another prohibited subsidy measure can be justified.

D. EVALUATION BY THE PANEL

1. Introduction

7.20 We structure our evaluation as follows. First, we identify the relevant guiding principles in Article 21.5 proceedings in light of the text of Article 21.5 of the *DSU*. Second, we apply these guiding principles to the case before us. In so doing, we identify the "measures taken to comply with the recommendations and rulings" within the meaning of Article 21.5 of the *DSU* and consider whether those measures are consistent with the United States' obligations under the relevant covered agreements. Third, we consider our terms of reference. Finally, we state our conclusions.

7.21 We are guided by Article 3.2 of the *DSU*, which provides that Members recognise that the dispute settlement system serves to clarify the provisions of the covered agreements "in accordance with customary rules of interpretation of public international law." In this regard, Article 31.1 of the *Vienna Convention on the Law of Treaties* ("*Vienna Convention*")[46] provides:

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

2. Guiding principles under Article 21.5 of the *DSU*

(a) Relevant treaty text

7.22 Article 21.5 of the *DSU* governs the proceedings of this Panel.[47] It states:

> "Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report."

7.23 Article 21.5 of the *DSU* operates in circumstances where there is a "disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings".

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[46] (1969) 8 *International Legal Materials* 679.

Article 32 of the *Vienna Convention* is also generally accepted as such a customary rule (see, for example, Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 11). It provides:

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

[47] These proceedings are also framed by our terms of reference. We address our terms of reference, *infra*.

7.24 For the purposes of this case, we see three relevant textual elements in Article 21.5 of the *DSU*: i) "the existence or consistency with a covered agreement of..."; ii) "measures taken to comply with"; and iii) "the recommendations and rulings". We examine each in turn.

(b) "existence or consistency with a covered agreement"

7.25 An Article 21.5 panel adjudicates on disputes "as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings ...".[48] Article 21.5 panels may assess whether "measures taken to comply" implement specific "recommendations and rulings" adopted by the DSB in the original dispute[49],but must also examine either the "existence" of "measures taken to comply" or the "consistency with a covered agreement" of implementing measures.[50]

7.26 We also note that the expedited procedure in Article 21.5 of the *DSU* reinforces the principle of "withdrawal" of an inconsistent measure[51] and the requirement of "prompt compliance"[52] with recommendations and rulings, made under Article 19 of the *DSU*, as well as recommendations of "withdrawal" of prohibited subsidies under Article 4.7 of the *SCM Agreement.*[53]

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[48] As already mentioned, this is also informed by the Panel's terms of reference, which we discuss below.

[49] Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 40.

[50] *Ibid.*, paras. 40-41. The panels in *EC – Bananas III (Article 21.5 – Ecuador)* (paras. 6.8-6.9) and *Australia – Salmon (Article 21.5 – Canada)* (para. 7.10, subparagraph 9) reached essentially the same conclusion.

[51] See, e.g., Article 3.7 of the *DSU*, which states:

> "In the absence of a mutually agreed solution, the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements. The provision of compensation should be resorted to only if the immediate withdrawal of the measure is impracticable and as a temporary measure pending the withdrawal of the measure which is inconsistent with a covered agreement."

[52] This is expressed in both Article 3.3 and Article 21.1 of the *DSU*. Article 3.3 of the *DSU* states:

> "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

Article 21.1 provides:

> "Prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members."

See, for example, Panel Report, *Australia – Salmon (Article 21.5 – Canada)*, paragraph 7.10, subparagraph 9.

[53] That special and additional dispute settlement rule reads:

> "If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn."

Article 1.1 of the *DSU* applies the rules and procedures contained in the *DSU* to "disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1". This general rule is, under Article 1.2 of the *DSU*, subject to the special or additional rules and procedures on dispute settlement identified in Appendix 2 to the *DSU*. See, for example, Appellate Body Report, *US — Corrosion-Resistant Steel Sunset Review*, footnote 82 to para. 83. It is only where the provisions of the *DSU* and the

(c) "measures taken to comply"

7.27 We turn to the second textual element in Article 21.5 of the *DSU*: "measures taken to comply".

7.28 Article 21.5 of the *DSU* does not refer to just *any* measure[54] of a WTO Member, but rather to a "measure taken to comply". However, it does not further define what a "measure taken to comply" may be.

7.29 Read in its context, this term "measure taken to comply" is clearly informed by the particular "recommendations and rulings" which it implements. We discuss this further below.

7.30 At this point, however, we observe that a "measure taken to comply" within the meaning of Article 21.5 of the *DSU* may be different from the original measure and inconsistent with WTO obligations in ways different from the original measure.[55]

7.31 While the *measures* may change from the original to the compliance proceedings, the obligation to implement DSB recommendations and rulings *does not*. A "measure taken to comply" should be *fully consistent* with a Member's WTO obligations. In terms of prohibited subsidy disputes, this requires the withdrawal of the prohibited subsidy. A Member's obligation to withdraw a prohibited subsidy is a constant. It remains until *full* implementation of DSB recommendations and rulings is achieved.

(d) "recommendations and rulings"

7.32 We turn to the third textual element we have identified in Article 21.5 of the *DSU*: the "recommendations and rulings".

7.33 "Recommendations and rulings" are at the core of WTO dispute settlement.[56] As the title of Article 21 of the *DSU* makes clear, panel proceedings under Article 21.5 form part of the process of the "Surveillance of Implementation of the Recommendations and Rulings".

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special or additional rules and procedures of a covered agreement *cannot* be read as *complementing* each other that the special or additional provisions are to *prevail*. See, for example, Appellate Body Report, *Guatemala – Cement I*, para. 65.

[54] In *US – Corrosion-Resistant Steel Sunset Review*, para. 81, the Appellate Body addressed the concept of "measure". It stated:

> "... we start with the concept of "measure". Article 3.3 of the DSU refers to "situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by *measures taken by another Member*". (emphasis added) This phrase identifies the relevant nexus, for purposes of dispute settlement proceedings, between the "measure" and a "Member". In principle, any act or omission attributable to a WTO Member can be a measure of that Member for purposes of dispute settlement proceedings."

[55] Appellate Body Report, *Canada-Aircraft (Article 21.5 – Brazil)*, para. 36. The claims, arguments, and factual circumstances relating to the "measure taken to comply" may thus not, necessarily, be identical to those relating to the measure in the original dispute.

[56] Article 19.1 of the *DSU* provides: "Where a panel or the Appellate Body concludes that a measure is inconsistent with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement". Article 19.2 *DSU* emphasizes that: "In accordance with paragraph 2 of Article 3, in their findings and recommendations, the panel and Appellate Body cannot add to or diminish the rights and obligations provided in the covered agreements". The special or additional rule in Article 4.7 of the *SCM Agreement* requires that, upon finding a prohibited subsidy, the "panel shall recommend" that the subsidizing Member withdraw the subsidy without delay.

7.34 The text of Article 21.5 of the *DSU* does not itself indicate *which* are the relevant "recommendations and rulings". Several provisions of the covered agreements indicate that panels and/or the Appellate Body make "recommendations".[57] We believe that, in its context[58], the text of Article 21.5 of the *DSU*, refers to "recommendations and rulings" emanating from the DSB[59], as the authority to articulate operative WTO recommendations and rulings.[60]

7.35 Recommendations by a panel and/or the Appellate Body under Article 19 of the *DSU* (or Article 4.7 of the *SCM Agreement*) become effective only upon their adoption by the DSB. Once the DSB adopts a dispute settlement report, the findings and recommendations in that report become collective, operative DSB rulings and recommendations. The very notion of "measures taken to comply with the recommendations and rulings" in the text of Article 21.5 of the *DSU* is predicated upon DSB adoption of a panel/Appellate Body report. No compliance obligation would arise unless and until panel and Appellate Body recommendations and rulings are adopted by the DSB to become DSB recommendations and rulings. [61]

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[57] For example: the title of Article 19 and Articles 19.1, 19.2 of the *DSU*, addressing "Panel and Appellate Body Recommendations"; and the stipulation in Article 4.7 of the *SCM Agreement* that the "*panel* shall recommend" (emphasis added). As mentioned, the latter is a special and additional rule in Appendix 2 of the *DSU*. See *supra*, note 53. All such panel and Appellate Body "recommendations" are conditional upon a finding of inconsistency with an obligation in the covered agreements. We do not consider that any of these provisions conflict with the general proposition that it is the DSB that is the authority to articulate operative WTO recommendations and rulings. We thus need not entertain the notion that the special or additional dispute settlement provision in Article 4.7 of the *SCM Agreement* could prevail over the general dispute settlement arrangements to the extent of obviating the need for DSB endorsement of any panel finding (or, where it exists, recommendation), or, conversely, entirely undermining the ability of the DSB to adopt operative recommendations and rulings in prohibited subsidy disputes. We recall the following statement in Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 334: "Upon adoption, this additional [panel Article 4.7 SCM] recommendation — that the subsidizing Member "withdraw the subsidy without delay" — will become a recommendation or ruling of the DSB."

[58] We find contextual support in the covered agreements for our view that recommendations and rulings emanate from the DSB after their adoption. For example: the reference in Article 4.10 of the *SCM Agreement* to "...the recommendation of the DSB..."; the reference in Article 3.4 of the *DSU* to: "Recommendations and rulings made by the DSB..."; the reference in Article 7.1 of the *DSU* stipulating the standard terms of reference of panels to examine "the matter referred to the DSB by" the complaining party's panel request and "to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements"; the reference in Article 11 of the *DSU* that panels should, *inter alia* "make such other findings as will assist the *DSB in making the recommendations or in giving the rulings* provided for in the covered agreements" (emphasis added);the *DSU* Article 21.1 statement: "Prompt compliance with *recommendations or rulings of the DSB* is essential in order to ensure effective resolution of disputes to the benefit of all Members" (emphasis added); and the *DSU* Article 21.3 reference to "intentions in respect of implementation of the *recommendations and rulings of the DSB*"(emphasis added).

[59] See, for example, Article 2.1 of the *DSU*.

[60] We find further support for our view that the operative recommendations and rulings flow from the DSB in prior (adopted) dispute settlement reports. For example, the Appellate Body has clarified that: "Proceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those "measures taken to comply with the recommendations and rulings" *of the DSB*" (emphasis added) (Appellate Body Report, *Canada — Aircraft (Article 21.5 — Brazil)*, para. 36); and "As the title of Article 21 makes clear, the task of panels under Article 21.5 forms part of the process of the "Surveillance of Implementation of the Recommendations and Rulings" *of the DSB*." (emphasis added) (Appellate Body Report, *US — Shrimp (Article 21.5 — Malaysia)*, paras. 86–88).

[61] This view is consistent with the letter and spirit of the original GATT dispute settlement provision, Article XXIII:2 of the *GATT 1947/1994*. We are well aware that the *WTO Agreement* is different from the GATT system which preceded it, but that it contains many elements of continuity. The previous system was made up of several agreements, understandings and legal instruments, the most significant of which were the GATT 1947 and the nine Tokyo Round Agreements, including the *Tokyo Round SCM Code*. Each of these major agreements was a treaty with different membership, an independent governing body and a separate

7.36 Article 21.5 compliance proceedings form part of a continuum of events[62] flowing from the various steps in dispute settlement proceedings, with the operative recommendations and rulings for the purposes of Article 21.5 compliance proceedings being those adopted by the DSB in the *original* proceedings. These remain operative through compliance panel proceedings under Article 21.5 of the *DSU* until the "problem" is entirely "fixed", in terms of *full* withdrawal of the prohibited subsidy.

(e) Does Article 21.5 of the *DSU* require a new recommendation?

7.37 Before us, the United States asserts:

> "Any obligation to withdraw the ETI Act tax exclusion, or to withdraw it within a particular period of time, had to be triggered by a recommendation under Article 4.7. Because no such recommendation was made, the United States was not under an obligation to withdraw the ETI Act tax exclusion....Furthermore, there is no basis for an Article 21.5 panel to make a finding of compliance or noncompliance with a DSB recommendation or ruling under Article 4.7 of the SCM Agreement in this dispute, and thus the Panel should reject the EC's claims under Article 4.7 of the SCM Agreement."[63]

7.38 The United States also asserts that its answer to "...the EC's claim that the transition provisions of the [Jobs Act] are inconsistent with Article 4.7 is premised on the notion that the ETI Act tax exclusion was found to be inconsistent with the DSB recommendation under Article 4.7 to withdraw the FSC subsidies .... is straightforward: no such finding was ever made, nor did the DSB make a recommendation under Article 4.7 that the ETI Act tax exclusion be withdrawn."[64]

7.39 We understand the United States to argue that, in order for the European Communities' Article 4.7 claim to prevail, and/or for the United States to be under any obligation to withdraw the relevant parts of the ETI Act, it would have been necessary for the 2002 Article 21.5 Panel to make a new recommendation under Article 4.7 of the *SCM Agreement* that the United States withdraw the ETI Act.[65] Recalling that an issue before us is whether there is an operative Article 4.7 recommendation in respect of a measure taken to comply, we therefore consider the issue whether an Article 21.5 Panel is required to make a new recommendation under Article 19 of the *DSU* and/or Article 4.7 of the *SCM Agreement*.

7.40 We note that the focus of Article 21.5 of the *DSU* is helping parties to resolve a dispute. Article 21.5 of the *DSU* does not contain the terms "make recommendations". Nor, beyond the reference to monitoring compliance with existing recommendations and rulings, does it contain an

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dispute settlement mechanism. See, for example, Appellate Body Report, *Brazil – Desiccated Coconut*, p. 11. The *GATT 1947* was administered by the CONTRACTING PARTIES (acting collectively). The *Tokyo Round SCM Code* was administered by the Tokyo Round SCM Committee, comprised of the signatories to that *Code*. The GATT-era dispute settlement arrangements made it clear that the collectivity of the relevant Committee, rather than the panel, was responsible for formulating operative recommendations. In the current institutional framework of the WTO, the corresponding "collective" entity would be the DSB.

[62] Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 121.

[63] United States first written submission, para. 19.

[64] See United States oral statement at Panel meeting, para. 5:

[65] We note with some surprise the additional United States view that an Article 21.5 panel does not have any mandate to make a recommendation under Article 4.7 of the *SCM Agreement*. See US response to Panel Question 24. The United States appears to be asserting that it is not under any obligation to withdraw the prohibited ETI subsidies because of the purported lack of a recommendation by the first compliance Panel that, in the United States view, it had no mandate to make in the first place. We note that a logical extension of the United States arguments would be that, in such a situation, a Member could enact a new prohibited subsidy as a "measure taken to comply" and then *never* be under an obligation to withdraw that subsidy. We cannot subscribe to these views of the United States.

explicit reference to the "recommendation" provisions of Article 19 of the *DSU*, or to Article 4.7 of the *SCM Agreement*. We see no express requirement in the text of Article 21.5 of the *DSU* that a compliance panel must formulate recommendations upon finding an inconsistency with a covered agreement, including a recommendation under Article 4.7 upon a finding of inconsistency with Article 3 of the *SCM Agreement*.

7.41 In particular, we see nothing in Article 21.5 of the *DSU* requiring a panel to make a recommendation under Article 19 of the *DSU* or Article 4.7 of the *SCM Agreement*.

7.42 This flows from both the text and context of Article 21.5, in view of the object and purpose of the *DSU*.[66] In particular, Article 21.5 comes after the "recommendation" provision in Article 19 of the *DSU*, and the principle of "prompt compliance" in Article 21.1, as part of the WTO dispute settlement process. The title of Article 21 -- "Surveillance of recommendations and rulings"-- is telling. It informs us that the proceedings are to follow the implementation of recommendations and rulings that have been made. This finds further support in the particular nature and purpose of *compliance* panel proceedings.

7.43 In this respect, an Article 21.5 compliance procedure occurs *after* the DSB has already made recommendations and rulings based on Article 19.1 of the *DSU* (and/or Article 4.7 of the *SCM Agreement*). It is linked to the post-recommendation implementation period envisaged in Articles 21.1 and 21.3 of the *DSU*. This necessarily implies that the textual reference in Article 21.5 of the *DSU* to have "recourse to these dispute settlement procedures" *cannot* include the requirement to, once again, formulate *additional* recommendations under Article 19 of the *DSU* (and/or Article 4.7 of the *SCM Agreement*).[67] Why would it be necessary for a panel to again tell a Member to remove a situation of WTO-inconsistency that it has already been told to remove?

7.44 If an Article 21.5 panel made a new recommendation under Article 19 which, upon adoption by the DSB, required an additional time period for implementation, this would give an *additional* period of time for the Member concerned to bring itself into conformity with the covered agreements. Similarly, in a dispute involving a subsidy already found to be prohibited, if an Article 21.5 panel made a recommendation under the first sentence of Article 4.7 of the *SCM Agreement* to withdraw the prohibited subsidy "without delay", the panel would also presumably be required to "specify … the time-period within which the measure must be withdrawn".[68] This would, in effect, amount to giving an *additional* period of time for the Member concerned to withdraw the prohibited subsidies.

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[66] We recall the principles of treaty interpretation, *supra*, para. 7.21, and incorporate our comments, *supra*, paras. 6.11 - 6.13. In particular, we believe that Article 3.2 of the *DSU* articulates a fundamental tenet relating to the object and purpose of the *DSU*, including its special and additional provisions, such as Article 4.7 of the *SCM Agreement*: "The dispute settlement system of the WTO is a central element in providing security and predictability to the multilateral trading system." The *DSU* aims to achieve the fair, prompt and effective resolution of trade disputes. See, for example, Original Appellate Body Report, *US – FSC*, para. 166. In respect of the *SCM Agreement*, we recall and endorse the view of the 2002 Article 21.5 Panel that we must avoid an interpretation that "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." (para. 8.39) We consider that our interpretation of the text of the relevant treaty provisions, in their context, is reflective of their object and purpose. Moreover, this interpretation is entirely consistent with, reflective of, and confirmed by, the object and purpose of the *DSU* (and the *SCM Agreement*), as a whole.

[67] We disagree with the United States assertion that Article 4.7 of the *SCM Agreement* would not be available to an Article 21.5 panel by virtue of the reference in Article 21.5 to "recourse to these dispute settlement procedures", which the United States appears to understand refers only to the provisions of the *DSU*. As already mentioned, Article 4.7 of the *SCM Agreement* is a special and additional dispute settlement rule in Appendix 2 of the *DSU*. It applies as articulated in Article 1.2 of the *DSU*. See *supra*, note 53.

[68] Pursuant to the second sentence of Article 4.7 of the *SCM Agreement*.

7.45 This would mean that Article 21.5 compliance proceedings should result in *adding* to the "non-implementing" Member's rights under the covered agreements through an extension of the time-period for implementation. The Article 21.5 proceeding would thus risk undermining the recommendations and rulings adopted by the DSB, by revisiting an issue already addressed and definitively resolved by the DSB. We are also mindful that a compliance panel must take what has been decided by the DSB as a given.

7.46 Nowhere do we find any indication in the text or context of Article 21.1/21.5 of the *DSU* or of Article 4.7 of the *SCM Agreement*, nor in the object or purpose of the *DSU* (nor, for that matter, the *SCM Agreement*)[69] that would require repeated extensions of the implementation period in Article 21.5 *DSU* compliance proceedings. Indeed, such an interpretation would reduce the textual treaty terms "prompt compliance" and "without delay" to redundancy and inutility. We are not permitted to adopt such an interpretation. Such an approach might lead to a potentially never-ending cycle, whereby a Member continues to adopt non-compliant measures in order to win more time to comply with adopted DSB recommendations and rulings. This would entirely undermine the effective operation of the WTO dispute settlement system.[70]

3. Panel's application of guiding principles

(a) Panel's task under Article 21.5 of the *DSU*

7.47 The task of this Article 21.5 compliance Panel is to examine whether measures that the United States has taken to comply with the recommendations and rulings are consistent with the relevant covered agreements.[71] For this purpose, we first identify the "measures taken to comply" and the "recommendations and rulings" at issue.

(b) "measures taken to comply with" "the recommendations and rulings"

7.48 The "measures taken to comply with" "the recommendations and rulings" for the purposes of Article 21.5 of the *DSU* necessarily flow from the particular "recommendations and rulings" in question.

7.49 As in the 2002 Article 21.5 case, we take the view that the operative "recommendations and rulings" within the meaning of Article 21.5 of the *DSU* are those adopted by the DSB in the *original* dispute settlement proceedings, that is, the recommendations and rulings adopted by the DSB in 2000. These remained operative through the findings of inconsistency established in the Article 21.5 compliance proceedings, as adopted by the DSB in 2002. These findings confirmed that the United States had not "fixed the problem" of WTO-inconsistency identified in the original proceedings by withdrawing fully the prohibited subsidies.

7.50 The "measures taken to comply" with these recommendations and rulings are the ETI Act and the subsequent Jobs Act.[72] In particular, pursuant to the "transition provision" in section 101(d) of the Jobs Act, for certain transactions in the period between 1 January 2005 and 31 December 2006, a percentage of ETI benefits remain available (80 per cent in 2005 and 60 per cent in 2006). In addition, section 101(f) of the Jobs Act indefinitely grandfathers the ETI scheme in respect of certain

[69] See *supra*, footnote 66.

[70] By this, we do not mean to suggest that other elements outlined in the *DSU*, such as the possibility of an appeal, would not apply in compliance proceedings under Article 21.5 of the *DSU*.

[71] As indicated *supra*, footnotes 47 and 48, this task is also governed by our terms of reference. We address our terms of reference below.

[72] Neither party disagreed that the ETI Act and the Jobs Act are "measures taken to comply with" "recommendations and rulings" for the purposes of Article 21.5 of the *DSU*. See EC and US responses to Panel Questions 16 and 17.

transactions.[73] Furthermore, Section 101 of the Jobs Act does not repeal section 5(c)(1) of the ETI Act, indefinitely grandfathering FSC subsidies in respect of certain transactions.

(c) Article 4.7 of the *SCM Agreement* in the 2002 Article 21.5 proceedings

7.51 We recall our understanding of the United States argument: in order for the European Communities' Article 4.7 claim to prevail, and/or for the United States to be under any obligation to withdraw the prohibited ETI scheme, it would have been necessary for the 2002 Article 21.5 Panel to make a new recommendation under Article 4.7 of the *SCM Agreement* that the United States withdraw the ETI Act.[74]

7.52 We disagree with the United States. This is simply because the operative "recommendations and rulings" remain those adopted by the DSB in the original proceedings in 2000. The purpose of the 2002 Article 21.5 compliance proceeding was to decide whether the measures taken by the United States to comply with these recommendations and rulings did, in fact, bring the United States into a situation of consistency with its WTO obligations. The DSB found, *inter alia*, that the United States had not fully withdrawn the prohibited subsidies.

7.53 This Panel is of the view that the United States' obligation to withdraw the ETI scheme arises from the fact that the original recommendations and rulings adopted by the DSB recommended withdrawal without delay of the prohibited subsidies pursuant to Article 4.7 of the *SCM Agreement*; and the 2002 Article 21.5 Panel and Appellate Body reports, as adopted by the DSB, found that the ETI scheme was WTO-inconsistent in that, *inter alia*, it failed to fully withdraw the prohibited subsidies.

7.54 Article 21.5 of the *DSU* indicates that there is a procedure to decide a disagreement as to whether a Member has implemented DSB recommendations and rulings and "fixed the problem". It seems to us that an Article 21.5 compliance panel in a prohibited subsidies dispute may basically find one of two things. It may find that a Member has indeed "fixed the problem", as it has withdrawn the prohibited subsidy. Or, it may decide that the Member has not withdrawn, or fully withdrawn, the prohibited subsidy. We believe that either of these findings mark the completion of the task of an Article 21.5 panel.

7.55 Thus, we see no material significance in the purported lack of an explicit "new" Panel recommendation under Article 4.7 of the *SCM Agreement* in the first compliance proceeding.

7.56 In any event, the 2002 Article 21.5 Panel expressly indicated the view that the original Article 4.7 recommendation "remain[ed] operative". For its part, the Appellate Body recommended "that the DSB request the United States to implement fully the recommendations and rulings of the DSB in *US – FSC*, made pursuant to Article 4.7 of the *SCM Agreement*."[75] Furthermore, the Appellate Body recommended that the United States bring the ETI measure into conformity with its obligations under the relevant covered agreements, *including the SCM Agreement*.[76] These adopted recommendations and rulings recognize the continuing non-withdrawal of the prohibited subsidies and the continuing obligation on the United States to withdraw them fully pursuant to Article 4.7 of the *SCM Agreement* and to bring itself into conformity with the relevant covered agreements, including the *SCM Agreement*. Thus, with our finding that Article 21.5 proceedings need not produce new recommendations and rulings, we observe that operative recommendations nonetheless persist.

[73] We recall and incorporate our description of the factual aspects of these measures, *supra*.

[74] We recall and incorporate our discussion of the US arguments, *supra*, paras. 7.37-7.39. We further recall our view *supra*, note 65, that it is difficult to reconcile this United States argument with the United States argument that the Article 21.5 panel had no mandate to make such a recommendation.

[75] 2002 Article 21.5 Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para.257.

[76] 2002 Article 21.5 Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para.257.

In light of the Panel's clear expression in the first compliance proceedings that the original recommendation remained operative, the United States could not reasonably have been unaware that operative withdrawal recommendations persisted.

7.57 The United States also asserts that the Appellate Body recommendations in the first compliance proceeding relating to Article 4.7 do not pertain to the ETI Act, as the Appellate Body in the first compliance report referenced the recommendations and rulings in the original proceedings, which were made before the ETI Act tax exclusion even existed.

7.58 We agree that the *original* recommendations and rulings predated the United States enactment of the ETI Act, which was, indeed, a measure "taken to comply" with these recommendations and rulings. However, we do not believe that this has the consequences advocated by the United States. In a prohibited subsidies case, the obligation upon a WTO Member to implement original DSB recommendations and rulings does not disappear until that Member has fulfilled the obligation by *fully* withdrawing a prohibited subsidy.

(d) existence or consistency of the measures taken to comply

7.59 We now address the existence or consistency of the identified "measures taken to comply". We turn first to the provisions of the Jobs Act continuing for a transition period and indefinitely grandfathering the ETI scheme in respect of certain transactions.[77]

7.60 The panel and Appellate Body findings in the first 21.5 compliance proceedings, as adopted by the DSB, established that the ETI scheme was in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of the GATT 1994. Pursuant to Articles 101(d) and (f) of the Jobs Act, the ETI benefits remain available throughout 2005 and 2006 (albeit at reduced percentages[78]), and indefinitely (in the case of certain transactions). The inconsistencies with Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the *Agreement on Agriculture* and Article III:4 of GATT 1994 remain.[79]

7.61 We further note the indefinite grandfathering of the original FSC subsidies for certain transactions, through the continued operation of section 5(c)(1) of the ETI Act.[80] As confirmed by the United States in response to Panel questioning, nothing in the legislative language of the Jobs Act modifies, implicitly or explicitly, these transition rules for the FSC subsidies.[81]

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[77] This dispute may be viewed as one on the "existence" of a measure which in its substance complies with prior recommendations and rulings. Nevertheless, this clearly can also be framed in terms of "consistency". We recall that we have before us claims regarding a measure that does certain things (repeals *e.g.* Sections 3 and 4 of the ETI Act, subject to transition and grandfathering provisions) and omits to do other things (i.e. affect the operation of the grandfathering of the original FSC). In any event, the result is unchanged whether we frame this in terms of "existence" or "consistency".

[78] Although the phased reduction in amount of subsidy available in 2005 and 2006 may be relevant in another type of proceeding, such as an arbitration under Article 22.6 of the *DSU* or Article 4.10 and 4.11 of the *SCM Agreement*, the fact that, in 2005 and 2006, the percentage of subsidy available is less than the entire amount that was available under the ETI Act before 2005 is not material to our inquiry under the Article 21.5 *DSU* proceeding. The conditions and circumstances surrounding the granting of this subsidy remain otherwise unaffected.

[79] See 2002 Article 21.5 Panel and Appellate Body Reports, *US – FSC (Article 21.5 – EC)*, paras. 8.168, 8.170 and 9.1; and paras. 229-231 and 256-257, respectively.

[80] In substance, these are the very same prohibited export FSC subsidies already found to be inconsistent with the United States WTO obligations in the original dispute settlement proceedings. Furthermore, in both substance and form, these are the very same ETI Act provisions grandfathering the original prohibited export FSC subsidies already found to be inconsistent with the United States WTO obligations in the 2002 Article 21.5 compliance proceedings.

[81] See, for example, US response to Panel Question 2.

7.62 It is clear that continuing to grant subsidies found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".[82]

7.63 As stated in the prior Article 21.5 proceedings in this dispute[83], this WTO obligation to withdraw prohibited subsidies is unaffected by contractual obligations that the Member itself may have assumed under its applicable domestic legislation or regulation. Similarly, this obligation cannot be affected by contractual arrangements which private parties may have made in reliance on laws conferring prohibited export subsidies.

7.64 Therefore, the United States obligation to implement the operative DSB recommendations and rulings to withdraw fully the prohibited subsidies under Article 4.7 of the *SCM Agreement* and to bring its measures fully into conformity with the obligations under the relevant covered agreements remains.[84]

7.65 Accordingly, we find that, to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through these transitional and grandfathering measures, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.

4. Panel's terms of reference

7.66 The United States alleges that Section 5 of the ETI Act, indefinitely grandfathering the *original* FSC scheme in respect of certain transactions, is not within this Panel's terms of reference. The European Communities disagrees.

7.67 We recall that the terms of reference dictate the scope of a panel's mandate and determine its task. This obviously holds true in these Article 21.5 compliance proceedings.[85]

7.68 We first observe that, irrespective of whether or not section 5 of the ETI Act is within our terms of reference, it is a matter of fact that the Jobs Act neither repeals nor explicitly or implicitly affects the operation of section 5 of the ETI Act in any way. The United States remains under an

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[82] See, for example, Appellate Body Report, *EC – Export Subsidies on Sugar*, paras. 333-335.

[83] See 2002 Article 21.5 Panel Report, *US – FSC (Article 21.5 – EC)*, para. 8.168, and 2002 Article 21.5 Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 230.

[84] Having made these findings, it is not necessary for us, for the purposes of resolving this dispute, to consider whether or not Articles 19.1 and 21.1 of the *DSU* embody implicit obligations on Members. Accordingly, we exercise judicial economy with respect to the "claims" of the European Communities under those provisions. We note that the European Communities conceded that such an exercise of judicial economy would be appropriate. See EC response to Panel Question 10.

[85] We find support for this proposition in, *inter alia*, the following Appellate Body statements:

> "the task of a panel under Article 21.5 is to examine the "consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. That task is circumscribed by the specific claims made by the complainant when the matter is referred by the DSB for an Article 21.5 proceeding."
>
> Appellate Body Report, *US — Shrimp (Article 21.5 — Malaysia)*, paras. 86–88.
>
> "As in *original* dispute settlement proceedings, the "matter" in Article 21.5 proceedings consists of two elements: the specific *measures* at issue and the legal basis of the complaint (that is, the *claims*)."
>
> Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 78.

obligation to withdraw the prohibited subsidies without delay as a result of the original recommendations and rulings and the first compliance proceedings in this dispute.

7.69 In addition, and in any event, we examine whether or not section 5 of the ETI Act, grandfathering the original FSC subsidies, is within our terms of reference.

7.70 It is well established that a panel's terms of reference are governed by a complainant's panel request, and that a panel request must satisfy Article 6.2 of the *DSU*. Article 6.2 of the *DSU* reads:

> "The request for the establishment of a panel shall be made in writing. It shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. In case the applicant requests the establishment of a panel with other than standard terms of reference, the written request shall include the proposed text of special terms of reference."

7.71 There are two distinct requirements in this provision, namely identification of *the specific measures at issue*, and the provision of a *brief summary of the legal basis of the complaint*. Together, they comprise the "matter referred to the DSB", which forms the basis for a panel's terms of reference under Article 7.1 of the *DSU*.

7.72 The issue before us does not involve the omission of a legal basis for a claim. Rather, it concerns an alleged failure to identify a *measure at issue* (Section 5 of the ETI Act, grandfathering original FSC subsidies).

7.73 This measure would be within our terms of reference to the extent that it is *adequately identified* in the EC request for the establishment of the Panel, as required by Article 6.2 of the *DSU*.

7.74 In general, when faced with a question relating to the scope of its terms of reference, a panel must "examine the request for the establishment of the panel very carefully to ensure its compliance with both the letter and the spirit of Article 6.2 of the *DSU*."[86] The task of assessing the sufficiency of a panel request for the purpose of Article 6.2 may be undertaken on a case-by-case basis, in consideration of the panel request as a whole, and in the light of the attendant circumstances.[87] There may be a need to consider whether the defendant's ability to defend itself was prejudiced in light of the text of the panel request.[88]

7.75 We thus begin our analysis by closely examining the text of the EC Panel request.[89]

7.76 First, we consider that the EC Panel request should be read as a whole.[90]

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[86] Appellate Body Report, *EC – Bananas III*, para. 142.

[87] Appellate Body Report, *US – Carbon Steel*, para. 127.

[88] A defending party is entitled to know what case it must answer and what violations have been alleged in order that it may begin preparing its defence. This fundamental due process requirement ensures a fair and orderly conduct of dispute settlement proceedings. Appellate Body Report, *Thailand-H-Beams*, para. 88. An inadequate panel request may prejudice a defendant's ability to defend itself, given the actual course of the panel proceedings. This consideration may be among the attendant circumstances entering into a panel's inquiry under Article 6.2 of the *DSU*. See for example, Appellate Body Report, *Korea-Dairy*, para. 127.

[89] The text of the EC Panel request, document WT/DS108/29, is attached to this report (Annex E).

[90] The EC Panel request contains three sections: "The history of the dispute"; "The subject of the dispute"; and "Request for establishment of a Panel". Given that there are no requirements as to the precise *formatting* (as opposed to the content) of Panel requests, we do not consider that these titles are dispositive. Thus, we reject the United States argument that our terms of reference should be limited to that part of the document entitled "subject of the dispute".

7.77 It begins with an overview of developments in this dispute since the original panel proceedings (including the DSB recommendations and rulings arising from the original proceedings and the 2002 Article 21.5 proceedings, and the enactment of the Jobs Act). This includes the following statements:

> "On 15 November 2000, the President of the United States signed into law the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, US Public law No 106-519 (the "ETI Act")."
>
> "On 20 December 2000, the matter was referred back to the Panel under Article 21.5 of the *DSU* and on 29 January 2002 the DSB adopted the Panel [WT/DS108/RW] and Appellate Body [WT/DS108/AB/RW] reports declaring that the ETI Act violates Articles 3.1(a), 3.2 and 4.7 of the *SCM Agreement*, Articles 8, 10.1 and 3.3 of the Agreement on Agriculture and Article III:4 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994"), so that the US had failed to fully withdraw its prohibited subsidy scheme and failed to implement DSB recommendations and rulings in this dispute."

7.78 Therefore, the text of the Panel request refers to the ETI Act in its entirety, and to the original DSB recommendations and rulings and the DSB adoption of the 2002 Article 21.5 panel and Appellate Body reports containing, *inter alia*, findings of inconsistency of Article 5 of the ETI Act.

7.79 As to the subject of the dispute, the EC Panel request states:

> "Section 101 of the JOBS Act purports to repeal the ETI Act (Section 101 (a)). However, at the same time, it effectively maintains part of the ETI Act tax exemptions for a transitional period up to the end of 2006 (Section 101 (d)). Furthermore, the repeal of the ETI Act does not apply to certain contracts, without any time limits (Section 101(f))."

It continues:

> "In the light of the above, the European Communities considers that Section 101 of the JOBS Act contains provisions which will allow US exporters to continue benefiting from the tax exemptions already found to be WTO incompatible (a) in the years 2005 and 2006 with respect to all transactions, and (b) for an indefinite period with respect to certain contracts. Thus, the United States has failed to implement the DSB's recommendations and rulings by failing to withdraw without delay schemes found to be prohibited subsidies under the *SCM Agreement* and to bring its legislation into conformity with its obligations under the *SCM Agreement*, the Agreement on Agriculture and the GATT 1994."

7.80 The EC Panel request thus presents the "subject" of the dispute as Section 101 of the Jobs Act. That provision repeals the ETI scheme, except those transactions falling within the ETI transition and grandfathering provisions expressly cited, and the FSC grandfathering provisions in section 5 of the ETI Act. Thus, we reject the US argument that our terms of reference should be interpreted as excluding Section 5 of the ETI Act because this provision bears on the scope of effective repeal of the ETI Act: section 101 does not repeal the FSC grandfathering provisions in section 5 of the ETI Act.

7.81 The EC Panel request further refers to the procedural circumstances of this Article 21.5 proceeding and requests the Panel to find the following:

– "that the United States has failed to withdraw its prohibited subsidies as required by Article 4.7 of the *SCM Agreement*, has failed to bring its scheme into conformity with its WTO obligations and has thus failed to implement the DSB's recommendations and rulings, as specified by the DSB on 20 March 2000 and on 29 January 2002, as required by Articles 19.1 and 21.1 of the *DSU*.

– that the United States continues to violate Articles 3.1(a) and 3.2 of the *SCM Agreement*, Articles 10.1, 8 and 3.3 of the Agreement on Agriculture and Article III:4 of the GATT 1994."

7.82 On a holistic basis, the text of the EC Panel request cites the ETI Act, in its entirety, as well as both the 2000 and 2002 (Article 21.5) panel and Appellate Body reports, including recommendations and rulings adopted by the DSB. The Panel request also refers to a *failure* to withdraw prohibited subsidies and a *failure* to implement DSB recommendations and rulings from the original and first compliance proceedings. Article 6.2 of the *DSU* requires identification of the specific measure at issue, but not specific aspects of a specific measure.[91] We find no specific requirement in Article 6.2 concerning the manner or method for identifying a specific measure at issue. If its content is adequately described in the Panel request, then the particular measure may be adequately identified. Together, we believe that the textual references in the EC Panel request embrace the ETI provisions grandfathering the original FSC scheme, as well as Panel and Appellate Body findings of inconsistency of Article 5 of the ETI Act, as adopted by the DSB. In our view, this clearly meets the requirements of Article 6.2 of the *DSU*.

7.83 In assessing whether the United States may be prejudiced by any apparent defects in the EC's panel request, we consider whether the EC Panel request identified the measures with sufficient clarity to allow the United States to defend itself.[92] In this regard, we are mindful that defects in a panel request cannot be "cured" in a subsequent submission of a complainant during a panel proceeding.[93] Nevertheless, a complainant's first written submission may confirm the meaning of the words used in the panel request.[94]

7.84 In its first written submission, the European Communities states:

> "the grandfathering clause for FSC subsidies contained in section 5(c)(1)(B) of the ETI Act is still in force and so this violation [of] Article 4.7 of the *SCM Agreement* subsists....the transitional and grandfathering clauses in the Jobs Act are identical in all material respects to those in the ETI Act, except that they provide for continued availability of ETI subsidies rather than FSC subsidies."

7.85 We are satisfied that the European Communities clearly made the distinction between the grandfathering of the FSC scheme for certain transactions by the ETI Act and the grandfathering of ETI subsidies for certain transactions by the Jobs Act, and that it wishes to challenge both.

7.86 In this connection, we recall that the original recommendations and rulings required withdrawal of the prohibited subsidies by 1 October 2000.[95] The United States was well aware of its obligations since at least that point in time. While it is clear to us that we, as an Article 21.5 panel, may not address claims that are not in the Panel request, we recall that the prohibited, grandfathered,

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[91] Panel Report, *EC – Trade Marks and Geographical Indications (US)*, p. 14, para. 11 of the Preliminary Ruling.

[92] Appellate Body Report, *Thailand – H-Beams*, para. 95.

[93] Appellate Body Report, *EC – Bananas III*, para. 143.

[94] Appellate Body Report, *US –Carbon Steel*, para. 127.

[95] As indicated in para. 1, *supra*, on 12 October 2000, at a special session, the DSB agreed to the United States' request to allow it a time period expiring on 1 November 2000 to implement the DSB recommendations and rulings.

FSC subsidies are before us for a *second* Article 21.5 Panel proceedings as part of a *continuum of events* flowing from the original and subsequent compliance proceedings. Consequently, we do not believe that the United States has been prejudiced in its ability to defend itself before us.

7.87 For these reasons, we find that section 5 of the ETI Act, grandfathering prohibited FSC subsidies, is within the terms of reference of this *second* Article 21.5 compliance Panel.

VIII. CONCLUSION

8.1 In light of the findings contained in Section VII above, we conclude that, to the extent that the United States, by enacting Section 101 of the Jobs Act, maintains prohibited FSC and ETI subsidies through the transition and grandfathering measures at issue, it continues to fail to implement fully the operative DSB recommendations and rulings to withdraw the prohibited subsidies and to bring its measures into conformity with its obligations under the relevant covered agreements.

8.2 Since the original DSB recommendations and rulings in 2000 remain operative through the results of the compliance proceedings in 2002, we make no new recommendation.