

**AUSTRALIA – SUBSIDIES PROVIDED TO
PRODUCERS AND EXPORTERS OF AUTOMOTIVE
LEATHER**

REPORT OF THE PANEL

The report of the Panel on Australia – Subsidies Provided to Producers and Exporters of Automotive Leather is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 25 May 1999 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

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

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
II.	FACTUAL ASPECTS	1
III.	PREVIOUS WTO DISPUTE SETTLEMENT PROCEDURES BETWEEN THE PARTIES WITH RESPECT TO THE SAME OR RELATED MATTERS	3
IV.	PROCEDURES ADOPTED BY THE PANEL GOVERNING "BUSINESS CONFIDENTIAL INFORMATION"	3
V.	FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES	4
VI.	PRELIMINARY ISSUES AND REQUESTS FOR PRELIMINARY RULINGS	5
	A. REQUEST FOR DOCUMENTS BY THE UNITED STATES	5
	B. ESTABLISHMENT OF THE PANEL.....	9
	C. "DISCLOSURE" OBLIGATIONS UNDER ARTICLE 4 OF THE SCM AGREEMENT	16
	D. ADMISSIBILITY OF EVIDENCE.....	21
VII.	MAIN ARGUMENTS OF THE PARTIES	24
	A. MEASURES.....	24
	B. NATURE OF THE EVIDENCE PRESENTED.....	29
	C. ARTICLE 1 OF THE SCM AGREEMENT.....	32
	1. "financial contribution"	32
	2. "benefit"	33
	3. calculation and allocation of the "benefit"	36
	D. ARTICLE 3.1(A) OF THE SCM AGREEMENT	41
	1. Text of Article 3.1(a).....	41
	2. Principles of treaty interpretation.....	41
	3. Interpretation of the phrase "contingent in law or in fact upon export performance".....	42
	(a) application of the customary rules of interpretation of public international law.....	42
	(b) operational considerations	57
	4. Application of Article 3.1(a) of the SCM Agreement in this dispute	60
	(a) "contingent, in law ... upon export performance"	60
	(b) "contingent ... in fact ... upon export performance"	60
	(i) General.....	60
	(ii) Prior measures and the designing of alternative assistance to Howe	62
	(iii) Intent.....	75
	(iv) Conditions of the assistance and the size of the domestic market.....	78
	<u>Factors including level of exports</u>	78
	<u>Factors other than level of exports</u>	91
	E. REMEDY	93
	F. TIME PERIOD FOR IMPLEMENTATION	93
VIII.	INTERIM REVIEW.....	94
IX.	FINDINGS	94
	A. PRELIMINARY ISSUES AND REQUESTS FOR PRELIMINARY RULINGS	96
	1. Australia's request for termination based on the existence of multiple panels regarding the same matter.....	96
	2. Compliance with Article 4.2 of the SCM Agreement.....	98
	3. Limitation on evidence and arguments	99
	4. Information acquired in the context of consultations held pursuant to the first request (WT/DS106/1) and Exhibit 2 to the United States first submission.....	101
	B. ARE THE MEASURES BEFORE THE PANEL EXPORT SUBSIDIES WITHIN THE MEANING OF ARTICLE 3.1(A) OF THE SCM AGREEMENT?	102

1. What are the measures before the Panel?	102
2. Are the measures before the panel "subsidies" within the meaning of Article 1 of the SCM Agreement?	103
3. Are the subsidies in question "contingent, in law or in fact" on export performance, within the meaning of Article 3.1(a) of the SCM Agreement?	104
(a) contingent in law	104
(b) contingent in fact	105
(c) analysis of the facts.....	107
(i) the payments under the grant contract	108
(ii) the loan contract.....	111
X. CONCLUSIONS AND RECOMMENDATION	112

I. INTRODUCTION

1.1 On 4 May 1998, the United States requested consultations with Australia under Articles 1 and 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") and Articles 4.1 and 30 (to the extent that it incorporates by reference Article XXIII:1 of the General Agreement on Tariffs and Trade 1994) of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement") regarding allegedly prohibited subsidies provided to an Australian producer and exporter of automotive leather, Howe and Company Proprietary Ltd. ("Howe"), or any of its affiliated and/or parent companies (WT/DS126/1).

1.2 The United States and Australia met on 4 June 1998.¹

1.3 On 11 June 1998, pursuant to Article 4.4 of the SCM Agreement and Article 1.2 of the DSU, the United States requested the immediate establishment of a panel to examine the consistency of the subsidies provided to Howe with Australia's obligations under the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), in particular those contained in the SCM Agreement (WT/DS126/2).

1.4 At the meeting of the Dispute Settlement Body ("DSB") on 22 June 1998, the DSB established a panel in accordance with Article 4.4 of the SCM Agreement and Article 6 of the DSU with standard terms of reference. The terms of reference were:

To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS126/2, the matter referred to the DSB by the United States 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. (WT/DS126/4)

1.5 On 27 October 1998, the United States requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the DSU. On 2 November 1998, the Director-General composed the Panel as follows:

Chairperson: H. E. Carmen Luz Guarda

Members: Mr. Jean-François Bellis
Mr. Wieslaw Karsz

1.6 The Panel met with the parties on 9-10 December 1998 and 13-14 January 1999.

1.7 The Panel submitted its interim report to the parties on 8 March 1999. On 15 March 1999, Australia and the United States submitted written requests for the Panel to review precise aspects of the interim report. The Panel submitted its final report to the parties on 23 March 1999.

II. FACTUAL ASPECTS

2.1 This dispute concerns certain assistance provided by the government of Australia to Howe, a wholly-owned subsidiary of Australian Leather Upholstery Pty. Ltd., which is owned by Australian Leather Holdings, Limited ("ALH"), part of which is owned by Schaffer Corporation, Ltd. Howe is the only dedicated producer and exporter of automotive leather in Australia. Automotive leather is

¹ Australia does not consider that this meeting constituted "consultations" under the DSU. See WT/DS126/3, 19 June 1998.

primarily used for seat coverings and other interior components of automobiles, such as head and armrests, centre consoles and door trim.

2.2 On 9 March 1997, the Australian government signed two contracts with ALH and Howe: a grant contract (the "grant contract") and a loan contract (the "loan contract") providing for funding for an assistance package. The Australian Department of State of Industry, Science and Resources² is the governmental authority responsible for administering the contracts and disbursing the payments thereunder.

2.3 The grant contract provides for a series of three grant payments totalling up to a maximum of A\$30 million. The aggregate of payments under the grant contract was capped at A\$30 million to limit the overall level of *ad valorem* subsidization of sales over the period to mid-2000 to approximately 5 percent.³ The payments were scheduled to occur in three instalments: the first payment of A\$5 million was to be paid upon conclusion of the grant contract; the second payment of up to A\$12.5 million was to be paid in July 1997 on the basis of Howe's performance against the performance targets set out in the grant contract for the period 1 April 1997 to 30 June 1997, as well as due diligence considerations such as whether the company was functioning properly; the third payment of up to A\$12.5 million was to be paid in July 1998 on the basis of Howe's performance against the performance targets set out in the grant contract for the period 1 July 1997 to 30 June 1998, as well as due diligence considerations such as whether the company was functioning properly. The performance targets consisted of sales targets and capital expenditure targets for certain specified periods: 1 April – 30 June 1997; 1 July 1997 - 30 June 1998; 1 July 1998 – 30 June 1999; and 1 July 1999 – 30 June 2000. Under the grant contract, Howe was required to use its best endeavours to achieve the performance targets. With regard to capital expenditure under the grant contract, the aggregate target for approved capital expenditure was \$22.8 million over the four-year period in question.⁴ The maximum amount of A\$30 million was essentially paid out in the three grant payments, in accordance with the grant contract.⁵

2.4 The loan contract provides for a fifteen-year loan of \$A25 million by the government of Australia to ALH/Howe. For the first five-year period of this loan, ALH/Howe is not required to pay principal or interest. After the expiration of this five-year period, interest on the loan is to be based on the rate for Australian Commonwealth Bonds with a ten-year maturity, plus two percentage points. The loan is secured by a second lien over the assets and undertakings of ALH.

2.5 These arrangements were put in place by the Australian government in compensation⁶ for the excision, as of 1 April 1997, of automotive leather from the Australian Textiles, Clothing and Footwear Import Credit Scheme⁷ (the "ICS") and the Export Facilitation Scheme for Automotive

² Before October 1998, this Department was known as the Department of Industry, Science and Tourism.

³ See para. 123 of Australia's first written submission; *infra*, para 7.191.

⁴ Howe constructed a new tannery at Rosedale and a new finishing plant at Thomastown. The latter was commissioned during February/March 1998 and commenced operating in April 1998. It replaced the old plant in Preston which was decommissioned during the same period and closed in May 1998.

⁵ A portion of the third payment of A\$12.5 million was held back pending completion of the audit process.

⁶ In response to questioning by the Panel, Australia stated that this was not "compensation" in the sense of off-setting a legal obligation on the part of the government of Australia, nor in the sense of trying to achieve an equivalent outcome, nor in the sense of it being an equivalent amount of assistance. Australia stated, however, that there was a political commitment to help maintain the commercial viability of Howe in the light of the settlement reached between Australia and the United States in November 1996.

⁷ The ICS has been in effect from 1 July 1991, and remains in effect through 30 June 2000. Under this programme, exporters of eligible textile, clothing and footwear products can earn import credits that may be used to reduce the import duties payable on eligible textile, clothing and footwear items by an amount up to the

Products⁸ (the "EFS") pursuant to a settlement agreement with the United States reached in November 1996. This excision was enacted on 26 March 1997 by Australian Customs Notice No. 97/29. Automotive leather will be part of the general textile, industry and clothing arrangements due to come into force in Australia on 1 July 2000.

III. PREVIOUS WTO DISPUTE SETTLEMENT PROCEDURES BETWEEN THE PARTIES WITH RESPECT TO THE SAME OR RELATED MATTERS

3.1 On 7 October 1996, the United States requested consultations with Australia concerning subsidies available to leather under the ICS and any other subsidies to leather granted or maintained in Australia which were prohibited under Article 3 of the SCM Agreement.⁹ Following one round of consultations, the United States and Australia reached a settlement on 24 November 1996. This settlement was announced on 25 November 1996. Under the terms of settlement, the government of Australia would excise automotive leather from eligibility under the ICS, as well as under the EFS, by 1 April 1997. On 26 March 1997, Australian Customs Notice No. 97/29 excised automotive leather from the ICS and EFS, effective 1 April 1997.

3.2 On 10 November 1997, the United States requested consultations regarding "prohibited subsidies provided to Australian producers and exporters of automotive leather, including subsidies provided to Howe Leather" which the United States understood to "include the provision by the government of Australia of an \$A25 million loan on preferential and non-commercial terms and grants amounting potentially to another \$A30 million."¹⁰ Consultations held between the United States and Australia on 16 December 1997 failed to resolve the dispute. At its meeting of 22 January 1998, the DSB established a panel in accordance with Article 4.4 of the SCM Agreement and Article 6 of the DSU pursuant to the request made by the United States on 9 January 1998. That panel was never composed.

IV. PROCEDURES ADOPTED BY THE PANEL GOVERNING "BUSINESS CONFIDENTIAL INFORMATION"

4.1 Due to concern expressed by one of the parties concerning the submission to the Panel of sensitive business information, the Panel adopted "Procedures Governing Business Confidential Information" at its first meeting with the parties. Pursuant to these procedures, only "approved persons" – i.e. a Panel member, representative, Secretariat employee or a member of the Permanent Group of Experts (the "PGE") -- having filed with the Chairperson of the Panel a Declaration of Non-

value of the credits held. Exporters are not required to use their credits as offsets against import duties, but may transfer them to another holder in exchange for a cash payment. The value of import credits that can be earned is calculated as the F.O.B. value of an eligible export sale, multiplied by the Australian value-added content of the export sale. This total is multiplied by a specified "Export Phasing Rate". TCF Import Credit Scheme: Administrative Arrangements (March 1995), United States Exhibit 7. The ICS is managed by the Australian Customs Service on behalf of the Australian Textiles, Clothing and Footwear Authority.

⁸ The EFS has been in its current form since 1991, and remains in effect until 31 December 2000. The EFS allows Australian manufacturers to earn A\$1 of export credit for every dollar of eligible exports of covered automotive items. The value of exports eligible to earn exports credits is equal to the Australian value-added content of eligible exports, calculated as the F.O.B. sales price less the value of any imported components and raw materials. Export credits earned under this programme can be used to obtain rebates on the duties payable on eligible imports of automotive vehicles and automotive components or may be sold for cash to any importer of eligible goods who may similarly seek such rebates. The amount of import duty that can be rebated under this programme is determined by a tariff reduction schedule that varies depending on the year in which the export credit is used. Australian Department of Industry, Science & Technology, Report on the State of the Automotive Industry 1994 (June 1995), United States Exhibit 13.

⁹ WT/DS57/1, G/SCM/D7/1, 9 October 1996.

¹⁰ WT/DS106/1, G/SCM/D17/1, 17 November 1997.

Disclosure were permitted to view or hear information designated by a party as business confidential information in the course of the Panel proceedings. Such approved persons were under an obligation not to disclose that information, or allow it to be disclosed, to any other person other than another approved person, except in accordance with the Procedures. The Panel was under an obligation not to disclose business confidential information in its interim and final reports, but could make statements of conclusion drawn from such information. Accordingly, the Panel has taken steps to ensure that all information designated by a party as business confidential information has been omitted from this Panel Report. Where the Panel deemed it necessary, a description of the type of information concerned has been provided.

V. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

5.1 The **United States** asks the Panel to make the following preliminary requests and rulings:

- (a) that Australia produce, by 30 November 1998, authentic copies of certain documents¹¹ for review by the Panel and the United States;
- (b) "rejecting Australia's argument that any further proceedings before this Panel should be terminated";
- (c) "that the United States has met its obligations under Article 4.2 of the Subsidies Agreement"; and
- (d) "rejecting Australia's argument that the Panel should disregard those facts and argument not explicitly set forth in the consultation request".

5.2 With respect to the merits of the case, the United States requests the Panel to find that "Australia is in violation of its obligations under Article 3.1 of the SCM Agreement", and asks the Panel to "recommend that Australia withdraw the subsidy to Howe without delay".

5.3 **Australia** asks the Panel to make the following preliminary rulings:

- (a) that "the establishment of the Panel was inconsistent with the DSU and that as a consequence the Panel should terminate its work";
- (b) that "in WT/DS126/1 the United States did not meet its disclosure obligations under Article 4 of the Subsidies Agreement and that consequently the establishment of the Panel and the basis for the United States case before the Panel are irremediably flawed. Australia asks that, as a consequence, the Panel terminate the proceedings, or rule immediately that the United States has not demonstrated its claims before the Panel"; and
- (c) "If the Panel does not agree to the requests in subparagraphs [(a) and (b)] above, then Australia asks that the Panel rule that, as a result of the failure of the United States to fulfil its disclosure obligations under Article 4 of the Subsidies Agreement, all facts and arguments not explicitly spelled out in the request for the Panel (WT/DS126/1) will be disregarded for the purpose of the proceedings of the Panel. Of this evidence, Australia asks in addition that information acquired in the context of consultations under WT/DS106/1 be ruled to be confidential to that process

¹¹ These documents are listed *infra*, para. 6.1.

[footnote omitted] and not admissible before this Panel, including Exhibit 2 of the United States First Submission."

5.4 In the event that the Panel does not terminate the proceedings on the basis of Australia's requests for preliminary rulings, Australia requests the Panel to find that:

- (a) "the Loan does not fall under Article 3.1(a) of the Subsidies Agreement";
- (b) "the two first payments under the Grant contract do not fall under Article 3.1(a) of the Subsidies Agreement"; or
- (c) "if the Panel decides to consider subsequent payments or the Grant contract itself, none of the payments or the Grant contract itself falls under Article 3.1(a) of the Subsidies Agreement".

5.5 In addition, if the Panel finds that any measure before it is inconsistent with Article 3.1(a) of the SCM Agreement, then Australia requests that:

- (a) "consistent with Article 19.2 of the DSU, the Panel make no recommendation or suggestion regarding the way in which Australia should bring itself into conformity"; and
- (b) "consistent with Article 4.12 of the Subsidies Agreement, recommend that Australia have at least 7.5 months for implementation from the adoption of the Panel or Appellate Body report, i.e. at least half of that provided as a benchmark period in Article 21.3(c) of the DSU, but that this issue be addressed by the Panel and the parties after the circulation of the Interim Report setting out the Panel's draft findings on the nature of the measures before the Panel".

VI. PRELIMINARY ISSUES AND REQUESTS FOR PRELIMINARY RULINGS

A. REQUEST FOR DOCUMENTS BY THE UNITED STATES

6.1 In its first written submission to the Panel, the **United States** asked the Panel to request that Australia produce, by 30 November 1998, authentic copies of the following documents for review by the Panel and the United States:

- (a) "Any document which provides the grant from the Australian government to Howe, and any related documents;
- (b) The loan contract between the Australian government and Howe, and any documents related to that contract;
- (c) The report prepared by the accounting firm commissioned by the Australian government and used in devising the replacement package;
- (d) Financial statements of Howe (or related corporate entities) for the period 1989 to present;
- (e) Internal business plans or strategic plans of Howe (or related corporate entities) for the period 1995 to present;

- (f) Any correspondence between the Australian government and Howe (or corporate entities related to Howe), or vice versa, regarding the replacement subsidy package;
- (g) Annual reports of Howe (or related corporate entities) for the period 1989 to present; and
- (h) Any analysis or forecast of the Australian automotive leather market in the custody or control of the Australian government, Howe, or any entity related to Howe."

6.2 The United States indicated that it was prepared to agree to appropriate procedures necessary to protect any business confidential information contained in the documents. The United States asserted that it had requested most of this information in consultations with Australia, but the Australian government had to date been unwilling to provide it. The United States recalled that the Appellate Body Report in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India – Patents*") stated:

All parties engaged in dispute settlement under the DSU must be fully forthcoming from the very beginning both as to the claims involved in a dispute and as to the facts relating to those claims. Claims must be stated clearly. Facts must be disclosed freely. This must be so in consultations as well as in the more formal setting of panel proceedings. In fact, the demands of due process that are implicit in the DSU make this especially necessary during consultations. For the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings. If, in the aftermath of consultations, any party believes that all the pertinent facts relating to a claim are, for any reason, not before the panel, then that party should ask the panel in that case to engage in additional fact-finding.¹²

6.3 **Australia** responded that the obligation is upon the complainant, the United States, to come forward with the facts on which its case is based. There is no obligation upon Australia to provide the information sought by the United States. The United States could at any time have used the procedures of the SCM Agreement to seek information about the measures in question. Specifically, Australia pointed out, Article 25.8 of the SCM Agreement is the means by which a Member can seek information about measures of another Member. The United States chose not to use this procedural provision under the relevant agreement and so cannot expect that the information will be provided at its request in the Panel process.

6.4 The **United States** indicated that it had requested information, including information concerning notification of the subsidies as provided in Article 25.8 of the SCM Agreement, during consultations. According to the United States, at that time, Australia did not provide any of the requested information.

6.5 In **Australia's** view, the United States was misrepresenting the situation in implying that it was analogous to that before the Appellate Body in *India – Patents*.¹³ While the statement of the Appellate Body may have wider application, it was made in respect of a particular situation where the analogy for this case would be that there had been a substantial change affecting the measures before the Panel. Of course, it is within the scope of a Panel's working procedures to seek additional information from parties. However, that is for the Panel to do in the light of whether the admissible

¹² WT/DS50/AB/R, adopted 16 January 1998, para. 94.

¹³ *Ibid.*

evidence from the United States has made a case that warrants further investigation by the Panel. It is up to the complainant to make a case that there has been a breach of the rules.

6.6 Australia asserted that if the Panel were to rule against Australia's requests to terminate the Panel proceedings, then Australia wanted to cooperate with the Panel to enable it to reach its conclusions. Accordingly, if the Panel considered that the two contracts (i.e. the grant contract and the loan contract) were necessary for its deliberations, Australia was willing to provide the Panel with the two contracts, without the more sensitive commercial-in-confidence numbers that, in Australia's view, are not pertinent to issues under Article 3 of the SCM Agreement. However, Australia would look for assurances that the contracts would be treated as confidential information by both the Panel and the United States. There is only one medium-sized Australian company involved in this dispute and the mere fact of the United States' action has placed a great deal of commercial pressure and uncertainty on this company in the market place. This is a situation where a single company is involved and any information about its business is potentially valuable to its competitors. It is essential, therefore, that Howe's competitors do not gain further advantage from the disclosure of commercially sensitive information. Australia expressed its regret that statements by the United States to the Panel regarding Howe could only be understood as being driven by commercial considerations rather than legal argumentation for this Panel. It would be inappropriate for the government of Australia to provide further information on the contracts that would find its way quickly into the commercial domain.

6.7 Australia submitted redacted versions of the grant contract and the loan contract at the first substantive meeting of the Panel with the parties.

6.8 The **United States** expressed its appreciation for Australia's willingness to provide redacted copies of the grant contract and the loan contract and assured Australia that it would treat the information as confidential. At the first substantive meeting of the Panel with the parties, the United States urged the Panel to request that Australia provide the remaining information it had requested, in the belief that this information would better enable the Panel to make an objective assessment of the facts and their applicability under the SCM Agreement. The United States assured Australia that all information would be treated as confidential.

6.9 As noted below¹⁴, on 10 December 1998, the Panel ruled as follows with respect to the United States request that the Panel ask Australia to produce certain documents:

"... we note that Australia has already submitted redacted versions of the loan and grant contracts. In addition, among the questions from the Panel to the parties are certain requests for information and documents which we have concluded are relevant to our consideration of the issues in this dispute, and therefore have asked Australia to submit."

6.10 On 10 December 1998, as part of the written questions posed to the parties by the Panel after its first substantive meeting with the parties, the **Panel** asked Australia to provide the following to the Panel and the United States:

- (a) "the report prepared by the accounting firm commissioned by the Australian government and used in devising the compensation arrangements to Howe;

¹⁴*Infra*, para. 9.9 and note 182.

- (b) any correspondence between the Australian government and Howe (or corporate entities related to Howe) regarding the compensation arrangements to Howe and any documents relating to payments made under the grant contract which would indicate precisely what facts were taken into account in determining that Howe was in compliance with the performance criteria of the grant contract in order to make the grant payments to date, including the report for the year ending 30 June 1997 showing performance against the performance targets and the report for the year ending 30 June 1998 showing performance against the performance targets;
- (c) in the schedule of the grant contract, the numbers relating to performance targets (these could be indicated in indexed form, or as a range), the headings for categories of capital expenditure and the numbers for capital expenditure (these could be indicated in indexed form, or as a range);
- (d) any documents indicating the legal basis for the grant(s) and the loan in Australian law (for example, budget documentation); and
- (e) any records or reports of discussions in the Australian Parliament relating to the grant(s) and the loan."

6.11 On 17 December 1998, **Australia** responded, with respect to the report by the accounting firm commissioned by the Australian government and used in devising the compensation arrangements to Howe that:

"As part of the development of this compensation arrangements, the then Department of Industry Science and Tourism (DIST) engaged the firm of KPMG, Chartered Accountants, to assess the financial viability of Howe as a result of the removal of automotive leather from the ICS and EFS schemes. Under the terms of the engagement KPMG was required to examine certain information provided by Howe Leather and report to the Government of Australia. The report was to be strictly confidential between the Government of Australia and KPMG. In fact, KPMG agreed to undertake the engagement on the pre-understanding that "our report is solely ... for the information of the Australian Government and *is not to be used for any other purpose or distributed to any other party*". (emphasis supplied by Australia)

The Government of Australia often engages firms to carry out such reviews as part of its industry policy development. It is critical that these reports be completely candid and this means that confidentiality must be absolute. It is only to be expected in this case that the Government would require an independent assessment of the viability of the company."

6.12 Australia submitted, as business confidential information, redacted versions of the letters from ALH to the Department of Industry, Science and Tourism in July 1997 and July 1998 reporting on Howe's actual performance against the interim performance targets for the periods 1 April–30 June 1997 and 1 July 1997–30 June 1998, as well as a non-business-confidential attachment explaining the domestic law on "best endeavours" as it applied in this case. With respect to the Panel's request for the numbers relating to performance targets, the headings for categories of capital expenditure and the numbers for capital expenditure, Australia stated: "Any financial data provided either in indexed form or as a range would be amenable to deductive manipulation which could unfairly breach the

commercial confidentiality of any data so provided in good faith. Similarly, provision of any further details of the categories of capital investment undertaken by Howe could endow its competitors with an unfair commercial advantage. Accordingly, Australia regrets that it is unable to respond to this request by the panel." Australia asserted that the fundamental legal basis for the grant and loan is in the 1996/97 Portfolio Additional Estimates Statements for the Industry, Science and Tourism Portfolio of the Australian Government, in particular in the section entitled "Explanation of additional estimates 1996/97". Australia submitted a copy of this, as well as a digest of Appropriation Bill (No. 4) 1996/97 and extracts from the 1997-98 and 1998-99 Budget papers. Australia further stated that there had been no discussions in the Australian Parliament relating to the grant(s) and the loan.

6.13 On 12 January 1999, the **Panel** reiterated its request to Australia to provide:

- (a) "the report prepared by the accounting firm commissioned by the Australian government and used in devising the compensation arrangements to Howe; and
- (b) in the schedule of the grant contract, the numbers relating to performance targets (these could be indicated in indexed form, or as a range), the headings for categories of capital expenditure and the numbers for capital expenditure (these could be indicated in indexed form, or as a range)."

6.14 On 14 January 1999, **Australia** submitted to the Panel the numbers relating to the performance targets, the headings for categories of capital expenditure and the numbers for capital expenditure, as well as unredacted versions of the letters from ALH to the Department of Industry, Science and Tourism in July 1997 and July 1998 reporting on Howe's actual performance against the interim performance targets for the periods 1 April–30 June 1997 and 1 July 1997–30 June 1998.

B. ESTABLISHMENT OF THE PANEL

6.15 Australia asks the Panel to make an immediate ruling that the Panel was established inconsistently with the DSU and, therefore, the Panel should terminate these Panel proceedings. According to Australia, the DSU does not provide for the Panel to be established in the circumstances that prevailed. In particular, Australia argues that: the United States did not have the right to have a second panel established at the DSB meeting on 22 June 1998; the DSB did not have the right under the DSU to establish such a panel against the wishes of Australia and this was inconsistent with the DSU; accordingly, the Panel was not properly established; and consequently, the Panel should terminate its work immediately.

6.16 Australia notes that the United States asked the DSB to establish a panel on 9 January 1998 (WT/DS106/2), and that Australia did not oppose the right of the United States to have the DSB establish a panel, and this was done on 22 January 1998. That panel has never been composed, but it was established. That panel of the same title is in respect of the same matter, i.e. the claims that the "grants and loan" to Howe: "appear to violate the obligations of the government of Australia under Article 3 of the SCM Agreement ... may constitute subsidies 'contingent, ..., in fact, upon export performance' within the meaning of Article 3.1(a) and footnote 4 of the SCM Agreement." These are the same in the first and second substantial paragraphs of WT/DS106/1 and the second substantial paragraph of WT/DS126/1. The matter in both WT/DS106/1 and WT/DS126/1 consisted of the same specific measures ("grants and loan") and the same claims about those measures. Accordingly, each of the requests was about the same matter to be eventually referred to the DSB. The resulting requests for establishment of a panel, WT/DS106/2 and WT/DS126/2, were again about exactly the same matter.

6.17 Australia states that, in WT/DS126/2, the United States also asked that its earlier request for a panel in WT/DS106/2 be withdrawn.¹⁵ At the DSB meeting on 22 June 1998, the United States representative said that it had terminated that panel.¹⁶ The request for the establishment of a panel in WT/DS106/2 was not outstanding. The panel had been established on 22 January 1998 and, while it had not been composed, was still in existence. Either party could have had that panel composed at any time. The United States did not state any provision of the DSU under which it was seeking to terminate that panel or have it terminated by the DSB. The DSB did not terminate that Panel.¹⁷ The Chair at the meeting of the DSB of 22 June 1998 said that the arguments regarding the establishment of the Panel could be raised before the Panel itself.¹⁸

6.18 According to Australia, there is no provision under the DSU that allows one party unilaterally to terminate a panel once it has been established. The DSU allows the process to be terminated by mutual agreement by way of Article 12.7 of the DSU. Article 12.12 of the DSU allows the complaining party to ask a panel to suspend its work. The panel is not obliged to do so, but if it does, then after the expiry of 12 months (arguably 6 months for cases under the expedited procedures of Article 4 of the SCM Agreement) the authority for establishment of the panel would lapse.¹⁹ The complainant cannot demand the suspension, but it can seek it.

6.19 Australia asserts that if the complainant had the right under the DSU to terminate a panel unilaterally, then it would be clear from the text of the DSU that it had that right. However, the text of the DSU does not give it such a right. Indeed, it does not even have the right to require the suspension of the Panel's proceedings. One obvious reason for this is that while the terms of reference for the complaint and the timing of the complaint are very much in the hands of the complainant, some balance is given to the proceedings once the panel has been established. If the complainant could unilaterally terminate or suspend, and hence terminate a panel after the designated period, then it could, for example, do this if it did not like the Interim Report. That would allow it to avoid an adverse judgement and, if it desired, start again with a new panel virtually immediately. This sort of game-playing is not envisaged under the DSU. A Member has the right to a panel but it must then live with what it has sought and obtained from the DSB.

6.20 Accordingly, Australia contends, any attempt by the United States unilaterally to terminate the panel established pursuant to WT/DS106/2 was inconsistent with the DSU. A number of Members raised questions about the process at the DSB on 22 June 1998. Nonetheless, a panel was purportedly established on the same matter despite the objections of Australia, without the United States or any other participant providing any legal reasoning for having the rights of a Member overridden in this way. By way of clarification, Australia points out that it is not arguing that it might not be possible to have a second, or any number of, panels established on the same matter by mutual consent of the parties. However, the issue here is what right a complainant has under the DSU to have more than one panel established on the same matter where there is no consensus. There was no consensus at the meeting when this Panel was established.²⁰ The process of negative consensus under the DSU is a radical change in the way issues are handled under the WTO, when compared to the GATT, and only applies to the strictly limited situations set out explicitly in the DSU.

6.21 With respect to the issue of whether the DSB must, or indeed has the authority to, terminate a panel at the request of the complainant, Australia sees nothing in the DSU to allow the DSB to terminate a panel, whether by consensus or no. Certainly any action where negative consensus

¹⁵ WT/DS126/2, 11 June 1998, last sentence.

¹⁶ WT/DSB/M/46, 6 August 1998, para. 1 on p. 8 and the last paragraph on p. 9.

¹⁷ *Ibid.*, para. 5 on p. 9.

¹⁸ *Ibid.*, para. 2 on p. 10.

¹⁹ DSU, Article 12.12.

²⁰ Australia refers also to WT/DSB/M/46, 6 August 1998, para. 2 on p. 10.

applied would have to be explicit in the DSU: there is nothing in the DSU that provides for this. It is difficult to read even an implied authority to terminate a Panel even where consensus exists. Indeed, where there is consensus, the parties can terminate the panel proceedings by way of Article 12.7 of the DSU at any time where all parties to the dispute wish to do so. All that is required is agreement, which is required for a consensus decision by the DSB in any case.

6.22 With respect to the issue of whether a Member has the right to have a second panel established (in particular through a negative consensus decision) on the same matter, while the other panel is still in existence, Australia asserts that the DSU does not confer any such right. All that the DSU gives is the right to have one panel established on a matter provided that the correct procedures are followed. There is nothing to say that a Member can have any number of panels established on the same matter, which it can use at any time that it wishes.

6.23 Australia observes that the DSU has explicit provisions covering multiple complaints by more than one Member (Article 9 of the DSU) and the right of a third party to take a case of its own (Article 10.3 of the DSU), but that it does not provide for multiple panels by the same Member on the same matter. This was implicitly recognized by the United States when it sought in WT/DS126/2 and at the DSB meeting on 22 June 1998 unilaterally to terminate the existing panel (established pursuant to WT/DS106/2). Australia questions why, the United States sought to terminate the first panel in WT/DS126/2 at the DSB meeting on 22 June 1998 if it considered that it had the right to a second panel while the first one existed. On the one hand, if the United States had simply decided that it did not wish to pursue the panel established on 22 January 1998 (WT/DS106) and it considered that it could unilaterally terminate that Panel, why did it not do so before seeking consultations under WT/DS126/1 on 4 May 1998? Indeed, the United States never sought even to get Australia's agreement to terminate that Panel.

6.24 According to Australia, the object and purpose of the DSU, including relevant special or additional rules and procedures such as Article 4 of the SCM Agreement, are to provide for the settlement of disputes on a matter. The DSU provides for the right to the automatic establishment of a panel to examine the matter subject to the required procedures having been met. The object and purpose of the text are to provide for panel examination. Once that has been provided for, there is no basis for the establishment of further panels to examine precisely the same matter while the existing panel still exists. Under Article 8.7 of the DSU and Article 4.12 of the SCM Agreement, the United States could at any time from 2 February 1998 have asked the Director-General to determine the composition of the panel by 9 February 1998 or any later date. This was 84 days before the United States sought further consultations under WT/DS126/1 and 133 days before it asked the DSB to establish a new panel on 22 June 1998.

6.25 Australia contends that the United States itself chose not to pursue the composition of the panel established on 22 January 1998, and that the United States cannot now use the fact that the panel had not been composed as the basis for seeking a new Panel. To give a Member the automatic right to have any number of panels on precisely the same matter, including under the expedited procedures of Article 4 of the SCM Agreement, is nowhere provided for under the DSU and so the establishment of a panel in such circumstances is inconsistent with the DSU.

6.26 Australia questions, in the alternative, what the situation would have been if the United States' action in seeking to terminate the panel on 22 June 1998 were indeed consistent with the DSU. While Australia considers that this was not the case, even if it were true, the United States would still not have had the right to the immediate establishment of a new panel. The right to a panel depends critically upon the correct procedures having been followed. Given the continuing existence of the panel established on 22 January 1998 (WT/DS106), the United States did not have the right under the DSU to start the procedures leading to the automatic establishment of a new panel. It is clear from Article 5.3 of the DSU that the purpose of the consultations is to reach a mutually satisfactory

solution. Article 4.3 of the SCM Agreement says that "[t]he purpose of the consultations shall be to clarify the facts of the situation and to arrive at a mutually agreed solution." Where such consultations are about precisely the same matter for which a panel exists, it would be absurd to have separate consultations to seek a mutually satisfactory solution. That would not be consistent with the object and purpose of the text. Articles 11 and 12 of the DSU make it clear that it is envisaged that the panel process provides for obtaining a mutually satisfactory solution. Given that, it would be incoherent for the DSU to provide at the same time for a Member to have a new round of consultations under Article 4 of the DSU or Article 4 of the SCM Agreement in order to seek such a solution. Accordingly, the right to the consultation process under Article 4 of the DSU and Article 4 of the SCM Agreement does not exist while a panel on the same matter exists. Therefore, the United States would have been unable to satisfy the requirements under the DSU and Article 4 of the SCM Agreement necessary to obtain the right to have a panel established.

6.27 The **United States** asserts that the Panel should confirm that it was properly established and that it can and will consider the merits of the case presented to it by the United States. The DSU contains no bar to a second consultation request concerning the same measures. The DSU also contains no bar to the establishment of a second panel concerning the same measures. The Panel may not invent a bar to these proceedings where the negotiators of the DSU provided none; as provided in Article 3.2 of the DSU, panel recommendations and rulings "cannot add to or diminish the rights and obligations provided in the covered agreements."

6.28 The United States maintains that the facts detailed in its complaint have shown the following. The United States made a first request for consultations on this matter which did not include a statement of available evidence as required by Article 4.2 of the SCM Agreement. This request was legally inadequate to satisfy the requirements of Article 4.2. After realizing that this was the case, the United States then took the only action available to it to cure this essential defect; that is, the United States submitted a second request for consultations which identified the nature and extent of the available evidence establishing that the subsidies in question were prohibited export subsidies. The second consultation request was submitted because there is no procedure for amending a prior consultation request. With this second request, the United States commenced pursuit of a new dispute settlement complaint.

6.29 According to the United States, the Appellate Body recently endorsed that a complainant may pursue a second dispute settlement complaint on the same matter in *Guatemala – Antidumping Investigation Regarding Portland Cement from Mexico*²¹ ("*Guatemala – Cement*"). In that case, the United States asserts, the Appellate Body found that the panel erred in considering the dispute because Mexico had failed to identify a specific anti-dumping measure in its panel request. In reversing the panel, the Appellate Body noted that nothing in its findings precluded Mexico from pursuing another procedurally proper dispute settlement complaint on the same matter. The United States observes that the panel considering the complaint by the European Community in *India – Patents*²² has also addressed the issue of multiple dispute proceedings. In that dispute, India argued that the EC complaint should be concluded because that complaint could have been brought at the same time as the prior complaint by the United States on the same matter. The United States maintains that India argued, as Australia does here, for compulsory joinder of all claims in the first panel proceeding initiated. That panel rejected India's claim, as this Panel should reject Australia's. That panel noted that the rights of Member include "the freedom to determine whether and when to pursue a complaint under the DSU."²³

²¹ WT/DS60/AB/R, adopted 25 November 1998.

²² WT/DS79/R, adopted 21 October 1998

²³ *Ibid.*, para. 7.15.

6.30 The United States contends that, based upon *Guatemala – Cement*²⁴, Australia cannot dispute that the United States could have pursued another dispute settlement complaint on this matter if a panel had been composed based upon the first request for consultations and had later found that the proceedings should be terminated because the consultation request was inadequate. The Appellate Body made clear in *Guatemala – Cement* that no matter what the procedural defect may be in a Member's complaint, that Member does not thereby lose the right to bring a complaint. The Panel should reject any argument that the United States should lose any right to challenge the subsidies provided by Australia. Australia's objection to the convening of this Panel therefore only amounts to an objection to the sequence in which the same events would take place. The sequence argued by Australia -- a ruling by the first panel, rejection of the United States' complaint and a new complaint -- involves a considerable waste of time and resources of the WTO and of the parties.

6.31 In the view of the United States, the course of action taken by it did not in any way prejudice Australia. Furthermore, contrary to Australia's suggestion, this course of action does not invite game-playing. The United States is not suggesting that a complainant may unilaterally terminate panel proceedings at any time. In fact, this Panel need not address that question. The only issue before this Panel is whether a complainant may, before the panel has been composed, withdraw the panel request and request consultations on the same matter in order to pursue a new dispute settlement complaint. The United States asserts that the answer must be "yes". To find otherwise would lead to the absurd result that a complainant wishing to amend its consultation request after the establishment of the panel but before its composition must nonetheless proceed through the entire panel process, only to have to start over. To find otherwise would also force Members and a panel to proceed with a dispute that they know in advance will be fruitless.

6.32 The United States notes that Australia has also argued that the United States should have been forced to move forward with panel composition, rather than take action to cure the defects in its earlier consultation request and move forward anew. The United States notes that the panel examining the complaint of the European Community in *India – Patents*²⁵ has counselled that the rights of parties include the freedom to move forward with panel composition at whatever pace the parties desire. There have been a number of instances in the GATT/WTO in which parties have reached mutually satisfactory solutions during the panel composition process. One recent example is the dispute brought by eight WTO Members, including both the United States and Australia, against agricultural subsidies of Hungary, in which a mutually satisfactory solution was negotiated during the panel composition process. Had the parties been forced to compose the panel, or lose their right to pursue the dispute, it is possible that there would have been no settlement in that dispute.

6.33 The United States further notes the Australian argument that the right to consultations under Article 4 of the DSU does not exist while a panel on the same matter exists; that the right to establishment of a panel under Article 6.2 is dependent on the proper procedural steps having been completed; and that Australia's objection at the DSB meeting of 22 June 1998 therefore had the effect of blocking the establishment of this Panel. The United States rejects all of these propositions. Nothing in the DSU limits the right of a Member to request consultations at any time. Indeed, the provisions of Article 4.1 of the SCM Agreement provide that consultations may be requested "whenever a Member has reason to believe that a prohibited subsidy is being granted or maintained by another Member." (emphasis supplied by the United States) Australia's argument would place the Panel in the position of rewriting the DSU to insert new rights and obligations not provided by the drafters. Moreover, Australia's argument would open the door to procedural blockage in a wide range of disputes.

²⁴ WT/DS60/AB/R, adopted 25 November 1998.

²⁵ WT/DS79/R, adopted 21 October 1998.

6.34 The United States appreciates the points that Australia makes concerning the supposed danger of harassment. However, this Panel is not an appropriate forum to address these issues. An alternative forum exists to address these systemic concerns -- the ongoing review of the DSU now taking place in the DSB. This Panel has the duty to make an objective assessment of the facts, and is required to base its findings on the language of the DSU. It cannot make a ruling divorced from the explicit language of the DSU to address a systemic concern.²⁶

6.35 **Australia** points out that it did not object to the immediate establishment of the panel on 22 January 1998. However, Australia considers that it has an obligation to pursue the issue of the status of this Panel partly because of the real systemic implications. If panels were allowed to be established in this way, it would set an unfortunate precedent for the future. Australia deems that it has a right to an immediate ruling on this issue. It goes to the heart of fairness about whether the Panel should proceed or terminate the proceedings.

6.36 Australia maintains that negative consensus is an important step forward by the GATT/WTO system in guaranteeing that a Member can have a matter subject to examination by a panel, and guaranteeing that the outcome of the Panel (subject to the Appellate Body Report) will be adopted. It has proved itself to be a key to a more rigorous method of dispute settlement. However, Australia is strongly of the view that its use is strictly limited to those issues set out in the DSU. This goes to the heart of the legitimacy of the new dispute settlement system. It is fundamentally unfair not only to the other Member concerned but also to the Chair of the DSB, who as the real decision-maker under negative consensus, can be placed in an invidious position.

6.37 Australia states that at the DSB meeting of 22 June 1998, the Chair of the DSB said that Australia could raise this with the Panel.²⁷ That is what Australia has done. It is clear from the Minutes of that meeting that the Chair left this issue to be resolved in at least the first instance by the Panel, rather than letting it run to the Appellate Body. Australia argues that the claims and measures were the same in both WT/DS106/1 and WT/DS126/1, i.e. the same for both panels. Indeed, the United States admits as much when it refers to "the earlier panel request regarding the same subsidies".

6.38 According to Australia, the purpose of Article 6 of the DSU is to ensure that a Member can have a panel established to examine a matter, subject to the requirements of Article 4 of the DSU, and, in this case, Article 4 of the SCM Agreement. There is nothing to suggest that this provides for the use of negative consensus for the establishment of multiple panels by the same complainant against the same respondent. Australia is not discussing here whether or not two panels might be able to be established by mutual consent. Rather, Australia is focusing on the situation where consensus does not exist. Australia is arguing that the use of negative consensus must be jealously guarded. It must only be used in the narrow circumstances where it is explicitly provided for under the DSU.

6.39 Australia contends that the United States never asked Australia whether it was willing to have the panel under WT/DS106 abandoned and to allow the United States to start again. Australia was never asked whether it would agree to a new panel. Australia's systemic concern is that Australia was overridden at the DSB meeting on 22 June 1998 by the use of negative consensus when, in its view, the United States was not entitled as a right to a second panel. Regardless of Australia's view, a number of Members had concerns about the legal basis of the approach of the

²⁶ In this regard, the United States refers to *ibid.*, para. 7.23.

²⁷ WT/DSB/M/46, 6 August 1998, p. 10.

United States. If the United States considered that it had the right to a panel, why then did it not explain why it had that right at the meeting.

6.40 In Australia's view, the text needs to be read in the context of its object and purpose. Where a Member has a complaint about a matter, i.e. a claim about a measure, it has the right to ask for consultations on that matter with the view to resolving it. If those consultations are unsuccessful, that Member has the right to have a panel established by the DSB to examine that matter. This right can be exercised through negative consensus. It then has the right to have the matter examined by the panel and either Member has the right to have the panel's report (possibly modified by the Appellate Body) adopted.

6.41 Australia asserts that when a Member has a panel established on a matter, it has decided that the consultation process had been unsuccessful. Australia queries why it would then be entitled to another round of consultations under Article 4 of the DSU on the same matter. Clearly, while a panel is in existence there is no basis for calling for consultations under Article 4 of the DSU. There is no impediment to discussions while a panel is in existence. Indeed, Article 12.7 of the DSU clearly envisages the prospect of a mutually satisfactory solution right up to the time of the submission of the final report of the panel. This is consistent with Article 3.7 of the DSU that a mutually acceptable solution is the preferred outcome of the process. The United States had no need to invoke Article 4 of the DSU again on 4 May 1998 in order to hold consultations with Australia. Australia considers that the United States did not have the right under Article 4 of the DSU to invoke consultations on a matter for which a panel was still in existence.²⁸

6.42 Australia observes that the United States could have asked the Director-General to compose the panel established on 22 January 1998 at any time that it wanted to from 2 February 1998. On 4 May 1998 if it wished to have a panel composed, it could have had one by 8 May 1998. Even on the basis of a 120 day period, the panel would have been concluded by 7 September 1998. Australia notes that the United States claimed at the DSB meeting to have the right unilaterally to terminate the panel established on 22 January 1998. The United States said: "we confirm that the United States has decided to terminate any action in pursuance of the DSB's decision following our request to establish a panel."²⁹ According to Australia, this was at odds with WT/DS126/2, where it said in the final paragraph that: "[t]he United States also asks that, at the next meeting of the Dispute Settlement Body, our earlier request for a panel, dated 9 January 1998, circulated as WT/DS106/2, regarding the same subsidies identified in the present request, be withdrawn." There was no outstanding request for a panel. The panel had been established nearly 5 months before.

6.43 Australia submits that it is unclear whether the United States considered that it wanted the DSB to terminate the first panel or whether it considered that it could do it unilaterally. Perhaps it thought both were true. What is clear, Australia continues, is that the United States thought that it needed to terminate the panel. Otherwise, it would not have sought to do so. The Chair of the DSB considered that the United States could not terminate the Panel unilaterally, since the minutes of that meeting of the DSB say: "The Chairman said that technically as from now two panels existed on this matter."³⁰ Clearly in the context of establishing this Panel, the Chair agreed implicitly that at least the first panel could not be terminated through negative consensus. There is, of course, nothing in the DSU that suggests that negative consensus applies to termination of panels. Indeed, Australia questions, why should there be? Negative consensus was introduced to ensure

²⁸ WT/DS126/3, 19 June 1998.

²⁹ WT/DSB/M/46, 6 August 1998, p. 9.

³⁰ *Ibid.*

that a complainant could have its day in court and that neither party could block the adoption of a panel report. Negative consensus is to be used on only the rarest of occasions. There would have been no reason to have negative consensus to terminate a panel. The DSU already provides explicitly for termination by agreement between the parties under Article 12.7. In addition, there is nothing in the DSU that says that a panel, once established, has some lower status in terms of the respondent's rights before it is composed. To the contrary, both parties have the same rights, for example, to ask the Director-General to compose the panel.

6.44 In relation to the statement by the United States that there is no bar in the DSU against a second panel, Australia points out that this does not address the issue whether the United States had the right to use negative consensus for the establishment of this Panel. Australia believes that the examples provided by the United States are not relevant to this case. This is a situation where the consultations were with the same Member but under a different dispute proceeding.

6.45 With respect to the references by the United States to *Guatemala - Cement*³¹, Australia agrees that Mexico's right to another panel in that dispute was endorsed by the Appellate Body. However, Australia points out, there are key differences in this case. The first is that the measure and hence, the matter in *Guatemala - Cement* was different from what was before that panel and what might be before a second panel. The other key difference was to do with the timing of Mexico's right to start again. Australia does not disagree with the right of a Member to a second panel. The difference of opinion between the United States and Australia is over when the right arises. *Guatemala - Cement* is now a completed panel. The January 1998 panel on automotive leather is not.

6.46 Responding to the United States' position that the sequence argued by Australia -- a ruling by the first panel, rejection of the United States' complaint, and the filing of a new complaint -- involves a waste of time and resources, Australia submits that the issue is that a complaining party has an obligation to meet the requirements of the DSU and the SCM Agreement in order to avoid wasting time. Australia does not accept that any Member who has *not* met those obligations can start again *during* a proceeding. The DSU does not provide for this. The discipline is on complaining parties to get it right at the time of request. Regarding the reference by the United States to the complaints by the European Community and the United States in *India - Patents*³², Australia submits that the issue in this case is fundamentally different. The panels dealing with India's measures were requested by *different* Members and not, as in this case, by the *same* Member.

C. "DISCLOSURE" OBLIGATIONS UNDER ARTICLE 4 OF THE SCM AGREEMENT

6.47 **Australia** asks the Panel to rule that, in its request for consultations (WT/DS126/1), the United States failed to meet its disclosure obligations under Article 4 of the SCM Agreement and therefore, the Panel should terminate the proceedings, or rule immediately that the United States has not demonstrated its claims. Australia views this as an important systemic issue, going beyond the circumstances of this particular case.

6.48 Australia notes that Article 4.2 of the SCM Agreement requires that: "A request for consultations under paragraph 1 shall include *a statement of available evidence* with regard to the existence and nature of the subsidy in question." (emphasis supplied by Australia) According to Australia, the reference to "evidence with regard to the existence and nature of the subsidy" in

³¹ WT/DS60/AB/R, adopted 25 November 1998.

³² WT/DS50/R, WT/DS50/AB/R, adopted 16 January 1998; WT/DS79/R, adopted 21 October 1998.

Article 4.2 includes not only facts but also argumentation why such facts would lead the complainant to consider that the measure in question was in breach of Article 3 of the SCM Agreement. Australia cites the United States' request for consultations (WT/DS126/1)³³ and asserts that the United States' request says little more than that the United States has evidence without saying what it is. It made no attempt to set out what facts it would use to support its case. The United States exhibits were only received by the Australian Mission in Geneva on 16 November 1998.

6.49 According to Australia, the description of evidence given in WT/DS126/1 does not meet any reasonable standard of disclosure as called for in Article 4 of the SCM Agreement, and accordingly, WT/DS126/1 does not satisfy the requirements of Article 4.2 of the SCM Agreement. In Australia's view, the expedited procedures provided for under Article 4 of the SCM Agreement mean that, in a dispute under this Article, the complainant is limited by the evidence that it puts forward in the request for consultations. This is clear from Article 4.2 of the SCM Agreement on consultation and underlined by the draft Rules of Procedures for the PGE.³⁴ Rule 9 of those draft procedures calls for simultaneous submissions. Under the WTO dispute settlement system, the obligation is on the complainant to make its case, i.e. "the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence".³⁵ Accordingly, under expedited procedures such as those provided for in Article 4 of the SCM Agreement, it is necessary that the complainant set out all its facts and arguments prior to the establishment of the panel. Thus, Australia argues, the United States is limited to using that evidence and those arguments explicitly set out in WT/DS126/1.

6.50 Australia also points out that the timing of some of the exhibits raises serious systemic questions. The complainant is required to provide a statement of available evidence at the time of the request for consultations. An important systemic issue is how much of that evidence can be developed after the request for consultations, or after the establishment, or even composition, of the Panel, under Article 4 of the SCM Agreement, but not provided to the respondent until the time of the first written submission to the Panel. Some of the United States exhibits are dated well after the request for consultations in WT/DS126/1. For example, some are dated after the request for the establishment of the Panel, while some are even dated after the composition of the Panel. Other exhibits are not even dated and some are essentially without provenance.

6.51 In the view of Australia, apart from the requirements of Article 4 of the SCM Agreement, any expedited procedures make the receipt of new material virtually impossible to consider in a timely manner. This problem can be compounded when new material is in non-electronic form. This emphasizes that any exhibits should have been provided at the time consultations were requested, whereas not even a list of these exhibits was provided by the United States before they were delivered in conjunction with its first written submission to the Panel.

³³ Australia cites the following paragraph from WT/DS126/1:

"This evidence consists of numerous statements and representations made by the GOA, Howe and Howe's affiliated and/or parent companies that have appeared in the media, official GOA publications and GOA communications with the United States Government. This evidence also consists of financial statements of Howe and its affiliated and/or parent companies; documents relating to the markets for automotive leather and automobiles in Australia; and other relevant information and materials concerning Howe, GOA export subsidy programs and the Australian market for automotive leather and automobiles, including statements of experts on automotive leather and automobiles, and statements of members of the automotive leather and automobiles industries."

³⁴ G/SCM/W/365/Rev.1, 24 June 1996.

³⁵ Appellate Body Report, *United States - Measure Affecting Imports of Woven Wool Shirts and Blouses from India* ("United States-Shirts and Blouses"), WT/DS33/AB/R, adopted 23 May 1997, p. 14.

6.52 Australia asserts that the United States' first submission had some 315 pages of non-electronic exhibits, and that the paucity of information in WT/DS126/1 and the appearance of alleged facts and arguments not covered in WT/DS126/1 raise a serious systemic issue. The object and purpose of expedited procedures are to deal with a measure that is causing such injury that it needs to have a quick resolution under the DSU. The aim of abbreviated procedures is not to place respondents in a disadvantageous position or to allow extended manoeuvring by the complainant. This places the obligation on any Member having recourse to Article 4 of the SCM Agreement to provide the respondent with the facts and arguments in advance, indeed at the time of requesting consultations. To allow a complainant to come forward with facts and arguments at the time of its first submission is inconsistent with Article 4 of the SCM Agreement. While, in this particular case, the time frame was extended by mutual agreement to beyond 90 days, the dispute remains under Article 4 of the SCM Agreement and such an extension does not affect the rights and obligations of the parties. Indeed, if the argument were to be made that this is some special case because of the extension of the time frame, the point would remain that the United States originally asked for consultations on this matter on 10 November 1997 and the communication referred to in WT/DS126/1 was dated 4 May 1998. If this was a genuine case for different procedures, then presumably the United States had made its case before then and could have provided Australia with the information at that time. Moreover, subsequently it was the United States that determined the precise date for its first submission through calling for the Director-General to compose the Panel. Presumably, it did that only after it had finalized its first submission, though at least two of its exhibits are dated later than that. While it would not have met the requirements of Article 4 of the SCM Agreement, the United States could have, even at that time, provided Australia with at least the facts that it intended to put forward.

6.53 The **United States** contends that the Panel should reject Australia's request. The plain language of Article 4.2 does not require that the consultation request include "argumentation". Nor does the rule require that a list of exhibits be included. Article 4.2 simply states that a statement of available evidence with regard to the existence and nature of the subsidy shall be included.

6.54 The United States submits that, as is now well-established, the provisions of the WTO Agreement must be interpreted in accordance with Article 31 of *the Vienna Convention on the Law of Treaties*³⁶ (the "*Vienna Convention*"), paragraph 1 of which 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." The ordinary meaning of the term "evidence" is as follows: "The available facts, circumstances, etc. supporting or otherwise a belief, proposition, etc., or indicating whether or not a thing is true or valid."³⁷

6.55 According to the United States, Australia has confused the requirements of the consultation request with the parameters for the first submission by a complaining party. The Working Procedures in Appendix 3 of the DSU provide in paragraph 4 that: "Before the first substantive meeting of the panel with the parties, the parties to the dispute shall transmit to the panel written submissions in which they present *the facts of the case and their arguments*." (emphasis supplied by the United States) There is no requirement in the DSU or the SCM Agreement that the complainant provide a statement of the facts and argument prior to the first submission. To impose such a requirement would render the first submission by the complainant pointless.

6.56 The United States maintains that the Panel must not lose sight of the facts that the provisions of Article 4.2 of the SCM Agreement relate to a request for consultations, not a panel request and not a panel submission. A request for consultations necessarily takes place before the consultations are

³⁶ Done at Vienna, 23 May 1969, 1155 U.N.T.S. 221; 8 International Legal Materials 679 (1969).

³⁷ *The Concise Oxford Dictionary*, 8th ed., Clarendon Press, p. 405.

held, at a time when the complaining party cannot be expected to know everything about the measure in question. Indeed, Article 4.3 of the SCM Agreement provides that one purpose of consultations is to "clarify the facts". The United States recalls that the panel in *United States – Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway* noted, "whereas the greatest degree of precision could be expected in the definition of specific claims in a panel request, the complaining Party could not be expected to define its specific claims with the same degree of precision at the time of its request for consultations."³⁸ If the evidentiary requirements of Article 4.2 are construed to require a complaining Member to know all about a subsidy at the time of the consultation request, this extreme burden will preclude recourse to Article 3 except by those Members with the largest resources for collection of information. According to the United States, this result was never intended by the drafters.

6.57 The United States argues that, even with regard to a panel request, the Appellate Body has found that it is sufficient "to list the provisions of the specific agreements alleged to have been violated without setting out detailed arguments as to which specific aspects of the measures at issue relate to which specific provisions of those agreements."³⁹ The Appellate Body has further noted that "there is a significant difference between the *claims* identified in the request for the establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the *arguments* supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties."⁴⁰ *A fortiori*, there can be no requirement to present legal "arguments" in a consultation request that starts the process of inquiry and dispute resolution under the dispute settlement provisions of the WTO Agreement.

6.58 The United States asserts that a review of its consultation request in WT/DS126/1 shows that it included a detailed statement of the available evidence which supports the United States claim that the subsidies in question contravene Article 3 of the SCM Agreement and which meets the requirements of Article 4.2 of the SCM Agreement. The request for consultations in WT/DS126/1 specifically provided:

"The United States bases this request for consultations on evidence indicating that the A\$25 million loan and grants of up to A\$30 million are in fact tied to Howe's actual or anticipated exportation or export earnings. In particular, this evidence indicates that:

- the grants and loan provide benefits to Howe, a company with a troubled financial history that has received GOA export subsidies in the past and that has relied on these subsidies to expand the exportation of its products;
- the grants and loan were provided to compensate Howe for the GOA's decision to excise automotive leather from two *de jure* export subsidy programme - the Textiles, Clothing and Footwear Import Credit Scheme (TCF) and the Export Facilitation Scheme for Automotive Products (EFS);
- the grants and loan have the same purpose and effect as the TCF and EFS programme - that is, to allow Howe to continue to expand the exportation of its products;

³⁸ ADP/87, adopted 27 April 1994, para. 334.

³⁹ Appellate Body Report, *European Communities – Regime for the Importation, Sale and Distribution of Bananas* ("European Communities – Bananas"), WT/DS27/AB/R, adopted 25 September 1997, para. 141.

⁴⁰ *Ibid.*

- the vast majority of Howe Leather's sales are exports, and this fact was well understood by the GOA when it agreed to provide the grants and loan to Howe;
- the Australian market is unable to absorb Howe's current production of automotive leather and thus cannot absorb a significant increase in that production - leaving exports as the only way Howe can utilize its increased production capacity and meet the aggressive production requirements upon which the grants and/or loan are conditioned; and
- the grants and loan provided to Howe, Australia's only exporter of automotive leather, differ from other subsidies given by the GOA and may well be unique.

This evidence consists of numerous statements and representations made by the GOA, Howe and Howe's affiliated and/or parent companies that have appeared in the media, official GOA publications and GOA communications with the United States Government. This evidence also consists of financial statements of Howe and its affiliated and/or parent companies; documents relating to the markets for automotive leather and automobiles in Australia; and other relevant information and materials concerning Howe, GOA export subsidy programs and the Australian market for automotive leather and automobiles, including statements of experts on automotive leather and automobiles, and statements of members of the automotive leather and automobiles industries."

6.59 Referring to Australia's implication that, given the expedited timetable of this dispute, Australia has been put in a disadvantageous position because it did not receive the specific exhibits relied upon by the United States until the time of the United States' first submission, the United States points out that, first, the evidence in this case was extensively described in the consultation request. This provided ample notice to Australia of the facts and evidence upon which the United States based its belief that the subsidies in question violated Article 3 of the SCM Agreement. Furthermore, the vast majority, if not all, of the documents submitted with the United States' first submission fall within the description of the evidence provided in the consultation request, and the principal facts relied upon in the first submission parallel the facts stated in the consultation request. Given the description of the evidence and the statement of the facts included in the consultation request, it seems disingenuous for Australia to claim that it has been somehow blind-sided or surprised by the facts and argument in the United States' first submission. Indeed, the United States asserts, Australia is more familiar than the United States with the nature and extent of the subsidies in question as well as the specific statements by its own government, the media in Australia and Howe regarding the purpose of the replacement subsidies, the Australian automotive leather industry and the financial condition of Howe in particular.

6.60 The United States points out that Australia would prefer if the United States had been required to present its first submission at the time of the panel request, and that Australia has proposed exactly such a change in the rules in the current review of the DSU. However, the DSU and the SCM Agreement now provide only the requirements in Article 4.2 of the SCM Agreement and Articles 4.2 and 6.2 of the DSU, which the United States asserts that it has satisfied in this instance.

6.61 **Australia** reiterates that, under Article 4.2 of the SCM Agreement, the complainant is required to provide a "statement of available evidence". This is one of the conditions it must meet if

it wants a panel established under the expedited time frames of Article 4 of the SCM Agreement. Australia asserts that the United States provided as a “statement of available evidence” in WT/DS126/1 a list of unspecified documents. It did not even provide citations of the documents it was referring to, let alone provide copies of those documents. Australia asks what use was that listing to Australia in assessing the case brought by the United States?

6.62 Australia submits that, at the time the complainant makes its request under Article 4.1 of the SCM Agreement, the ball is at its feet. It has total control over the paper work and over much of the timing of the process. If it follows the rules, then it can have a very quick outcome. However, it must follow the rules. In Australia's view, there is something essentially unfair and biased where the complainant can have expedited proceedings without the disclosure required under Article 4.2 of the SCM Agreement. If this practice were to be allowed, then a respondent could find itself in the future even making its first submission to the PGE on the basis of a statement that the complainant has evidence without specifying in any detail what it is.

6.63 In response to the statement of the United States on “disclosure” and on the meaning of “statement of available evidence”, Australia states that the issue here is that under expedited procedures of the SCM Agreement, the respondent has to know what the evidence is in order to prepare its case. This is different from usual DSU requirements. The *quid pro quo* of expedited proceedings is that the complainant must show its hand of the time of the request for consultations. The purpose of expedited proceedings is not to disadvantage the respondent, but rather to obtain a quick outcome. According to Australia, Article 4.2 of the SCM Agreement is supposed to be a guarantee that information necessary for a respondent to defend itself is provided.

D. ADMISSIBILITY OF EVIDENCE

6.64 **Australia** asserts that, in the alternative, if the Panel does not agree to its requests for an immediate ruling that the Panel proceedings should be terminated or that the United States has failed to establish its claims, the systemic issue of what evidence a panel (or the PGE) should accept still has to be resolved. If a statement in the request for consultations that amounts to little more in substance than “we have evidence” is regarded as sufficient to meet the disclosure requirements of Article 4 of the SCM Agreement, then that provision would be nullified. This could lead to legalizing a cat and mouse game between the complainant and the respondent, which would significantly alter the balance of rights under the SCM Agreement and, indeed, affect in a substantial way the balance of rights under the DSU. In Australia's view, the purpose of expedited proceedings is not to disadvantage the respondent. Thus, as a systemic requirement, complainants have to follow clear disclosure requirements.

6.65 In this context, Australia asks the Panel to rule that, as a result of the failure of the United States to fulfil its “disclosure” obligations under Article 4 of the SCM Agreement, evidence submitted by the United States that was not provided in WT/DS126/1 should not be admissible in the proceedings before the Panel. In the alternative, Australia asks that the Panel rule that at least those facts and arguments not explicitly set out in WT/DS126/1 but which would have been available to the United States at the time it requested the consultations will be disregarded for the purposes of the proceedings of this Panel. In support of this, Australia notes that Article 4.2 of the SCM Agreement says: “[a] request for consultations under paragraph 1 shall include a statement of available evidence with regard to the existence and nature of the subsidy in question.”

6.66 In addition, Australia alleges that the United States has referred to answers provided in the context of the consultations called for in WT/DS106/1 and urges the Panel to rule that any facts derived by the United States from those consultations, including Exhibit 2, and arguments by the United States based on them, are confidential to that process and not admissible before this Panel.

According to Australia, this raises a different systemic issue. This was part of the consultative process that led to the establishment of a panel by the DSB on 22 January 1998. That is not the same panel as the current process. Under Article 4.6 of the DSU, such consultations are confidential to that panel process and so any material provided in that context is required to be treated as being confidential to that panel process. As a systemic matter, such evidence should not be admitted before this Panel without Australia's agreement (and there was no consultation on this), since it was provided under a separate, confidential procedure. As a systemic issue, if Members cannot have confidence that the confidentiality provisions of the DSU will be respected, then these procedures will be undermined.

6.67 The **United States** asserts that it has satisfied the requirements of Article 4.2 of the SCM Agreement, and so the Panel need not consider Australia's arguments. If the Panel finds it necessary to consider these arguments, the United States submits that it would be inconsistent with the DSU and the SCM Agreement to limit the Panel to consideration of only those facts explicitly set forth in the consultation request. Article 11 of the DSU directs a panel to "make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements". The Panel's task of "objective assessment" under Article 11 is fundamentally incompatible with excluding from its examination relevant facts in the dispute before it. Australia argues that a supposed violation of Article 4.2 should be punished, but such a punishment is irrelevant and exceeds the authority given to the Panel under the DSU. If the consultation request in WT/DS126/1 has not satisfied the requirements of Article 4.2 of the SCM Agreement, the remedy would be for the complaining party to be required to start its case again.

6.68 According to the United States, no provision in the DSU or in the SCM Agreement provides a legal basis for the Panel to exclude facts simply because they were "available" at the time of consultations, but not explicitly stated in the consultation request. Article 4.2 of the SCM Agreement does not state that "all" available evidence must be included in a consultation request, or even that "the" available evidence must be included, thereby implying that the statement should be exhaustive. It simply requires that the complainant include "a statement of available evidence". Moreover, Australia does not suggest how the Panel should determine whether the evidence was "available" at the time of consultations. Just because a document may have been in existence at the time of consultations or a fact may have been ascertainable at that time, does not mean that the evidence was necessarily "available" to the complainant at that time. It would unduly prejudice a complainant if it could not continue its investigation and development of the facts after the request for consultations.

6.69 The United States submits that the Panel should reject the arguments raised by Australia on the issue of use in panel proceedings of material obtained during the consultations in WT/DS106/1. Article 4.6 of the DSU provides: "Consultations shall be confidential, and without prejudice to the rights of Members in *any* further proceedings" (emphasis supplied by the United States), without making any distinction whether the proceedings are in the same case or in other cases. There is no basis for distinguishing between the treatment of facts from consultations in a dispute used in a later phase of the same dispute, and the treatment of facts from consultations in one dispute used in another dispute. Indeed, the reference to "further proceedings" would seem to lead to the conclusion that if a panel excludes any evidence, it must start with evidence from earlier stages of the *same* dispute. Yet panels can base their conclusions on material from consultations, and have done so on many occasions. According to the United States, Article 4.6 cannot be interpreted so as to bar this widespread practice and frustrate the fact-finding ability of panels. Article 4.3 of the SCM Agreement provides that one purpose of consultations is to "clarify the facts". Yet there is no point in clarifying the facts if a complaining party cannot present the clarified facts to a panel. The logical implication of Australia's argument is that a complaining party should be required to present erroneous facts to the panel, even if the truth has been clarified in consultations.

6.70 The United States maintains that, in *India – Patents*, the Appellate Body recognized the widespread use in panel proceedings of facts from consultations:

All parties engaged in dispute settlement under the DSU must be fully forthcoming from the very beginning both as to the claims involved in a dispute and as to the facts relating to those claims. Claims must be stated clearly. Facts must be disclosed freely. This must be so in consultations as well as in the more formal setting of panel proceedings. In fact, the demands of due process that are implicit in the DSU make this especially necessary during consultations. For the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings.⁴¹

6.71 The United States points out that panels have also used material from other proceedings as a basis for their conclusions, for example, in *Argentina – Measures Affecting Imports of Textiles, Apparel, Footwear and Other Items*.⁴² As seen from the arguments at paragraphs 3.136-3.140, 3.153 and 3.164 and following in that panel report, the United States presented evidence based on a document given by Argentina to the European Community during consultations with the European Community in a related, but different, matter -- consultations which the United States had attended under Article 4.11 of the DSU. As paragraphs 6.48-6.50 of that panel report show, that panel relied on that evidence and those arguments as a basis for its factual and legal findings, and ruled that "the fact that the data was prepared by Argentina for other purposes is not relevant."⁴³ The Appellate Body later found: "We cannot find any error of law in the findings of the Panel based on the evidence submitted by the United States on average calculations ..."⁴⁴ -- that is, the evidence from consultations between Argentina and the European Community.

6.72 In the view of the United States, the real meaning and relevance of Article 4.6 can be seen in the panel report in *United States – Restrictions on Imports of Cotton and Man-made Fibre Underwear*⁴⁵ ("*United States – Underwear*"). In that dispute, Costa Rica used information on settlement offers made by the United States to advance certain arguments to the panel. The United States recalls that the panel found that:

In our view, the wording of Article 4.6 of the DSU makes it clear that offers made in the context of consultations are, in case a mutually agreed solution is not reached, of no legal consequence to the later stages of dispute settlement, as far as the rights of the parties to the dispute are concerned. Consequently, we will not base our findings on such information.⁴⁶

The United States argues that Article 4.6 of the DSU does not provide a basis for panels to mete out sanctions and exclude relevant factual evidence. It simply calls for panels to disregard offers of settlement, and not to treat such offers as admissions of guilt.

6.73 **Australia** repeats that, pursuant to Article 4.6 of the DSU, the consultations under WT/DS106/1 are supposed to be confidential and without prejudice to the rights of any Member in

⁴¹ WT/DS50/AB/R, adopted 16 January 1998 para. 94.

⁴² WT/DS56/R, adopted 22 April 1998.

⁴³ *Ibid.*, para. 6.51.

⁴⁴ WT/DS56/AB/R, adopted 22 April 1998, para. 61.

⁴⁵ WT/DS24/R, adopted 25 February 1997.

⁴⁶ *Ibid.*, para 7.27.

further proceedings. As a systemic issue, in Australia's view, the United States has no right to use this information in the context of this Panel without obtaining leave from Australia. Of course, if the Panel rules in favour of Australia on any of its other requests for preliminary rulings, then this issue becomes redundant.

VII. MAIN ARGUMENTS OF THE PARTIES

A. MEASURES

7.1 According to **Australia**, a key issue for any panel is what are the matters before it, in terms of claims and measures. Australia asserts that the United States documentation (WT/DS126/1 and WT/DS126/2) recognizes that there is more than one measure before the Panel. WT/DS126/1 says in its second substantial paragraph that: “these *measures* appear to violate the obligations of the [government of Australia]”. (emphasis supplied by Australia) Similarly, WT/DS126/2 says in its second substantial paragraph that: “these *measures* are inconsistent” (emphasis supplied by Australia). In addition, throughout both documents, the United States consistently refers to “subsidies”. Accordingly, Australia maintains, there are a number of different measures that the Panel will need to examine. Moreover, the Panel will need to examine these measures separately in respect of their consistency with Article 3.1(a) of the SCM Agreement.

7.2 Australia points out that the United States refers throughout WT/DS126/1 repeatedly to “grants” and to “the grants and loan”. The only measures specifically referred to in WT/DS126/1 are: “a A\$25 million loan, which was made on preferential and non-commercial terms, and grants of up to another A\$30 million”.⁴⁷ The United States goes on in the next sentence to refer to “*these measures* appear to violate ...” (emphasis supplied by Australia). In the third substantial paragraph of WT/DS126/1, the United States says that it: “bases this request for consultations on evidence indicating that the A\$25 million loan and grants of up to A\$30 million” In five of the six tirts to this paragraph, the United States refers to “the grants and loan”. The fourth substantial paragraph of WT/DS126/1 refers to “[t]his evidence”. Australia argues that, in light of Article 4.2 of the SCM Agreement, since “evidence” is only referred to about “loan and grants” and “the grants and loan”, these are the only measures covered by the claims of the United States.

7.3 Australia maintains that the “loan” is clearly the loan provided under the loan contract, and this leaves to be determined what is meant by “the grants”. According to Australia, the United States has not proposed that the grant contract is a measure under the dispute. Instead, it asked for consultations about the actual payments, “the grants”. There have been three payments made to date. Two were made in 1997 and one was made in July 1998, i.e. after not just the request for consultations but also after the establishment of the Panel. Australia contends that the term “grants” can only mean actual payments, since they have been distinguished from the actual grant contract, and that since the United States has referred to these payments severally, each of the grants before the Panel is a separate measure. This leaves the question of which payments under the grant contract are before the Panel.

7.4 Australia asserts that the second substantial paragraph of WT/DS126/1 says: “the [government of Australia] has provided subsidies to Howe that include ... grants of up to another A\$30 million.” The second tirt of the third substantial paragraph of WT/DS126/1 refers to “the grants and loan were provided”. Similarly, the first substantial paragraph of WT/DS126/2 says: “the Government of Australia has provided subsidies ... [that] ... include grants” These references can only be to payments that had been made already. The only payments under the grant contract that had been made by the time of these documents, and indeed the date of the establishment of the Panel, were the first two payments in 1997 (of A\$5 million and A\$12.5 million). Accordingly, the only

⁴⁷ WT/DS126/1, first sentence of the second paragraph.

grants referred to by the United States as measures in its request for consultations, and for the establishment of a Panel, were these first two payments. Thus, these, together with the loan, are the only measures covered by the Panel's terms of reference.

7.5 Australia states that the United States' claims are that each of the individual payments covered by the terms of reference of the Panel falls under Article 3.1(a) of the SCM Agreement. The United States' claims deal with each of the payments under the grant contract that are before the Panel as one of the separate measures at issue. No other explanation is consistent with the text and the normal meaning of the terms "grant" and "grants". Australia asserts that, in the alternative, even if the Panel decided to consider payments made subsequent to WT/DS126/1, or even to the establishment of the Panel, it should consider each payment as a separate measure.

7.6 Again in the alternative, regardless of the view the Panel takes of the issue of what aspects of the grant contract are before it, Australia argues that the United States has correctly recognized that the loan is a quite separate measure from the grant contract or payments under the grant contract. The documentation consistently talks of "measures" rather than "measure" and the only consistent interpretation of that is that the Panel is to examine each of the measures separately. The Australian government entered into two separate, independent contracts with the company, the loan contract and the grant contract. These are legally different, unrelated instruments. The United States has not made any allegation to the contrary. Australia contends that the Panel will need to assess the status under Article 3.1(a) of the SCM Agreement of each of the measures before it (i.e. the loan and the first two payments under the grant contract) on its own merits (or if the Panel takes the view that the grant contract is a measure before it, then the loan contract and grant contract as separate measures). For the sake of argument, even if the Panel finds that one of the measures was not consistent, it could find that the others were consistent with Article 3.1(a) of the SCM Agreement.

7.7 According to Australia, the United States recognized that the grant contract was provided only to cover the period through to 2000. Indeed, it is a major theme to the United States' argument that the grant contract was a "replacement" for automotive leather being excised from the ICS and the EFS. The loan, on the other hand, was provided for 15 years regardless of the duration of the previous or any future domestic support arrangements that might be subsequently introduced covering automotive leather.

7.8 Australia submits that the terms of the loan contract and grant contract are different. The United States recognizes in its first submission in particular that there is no conditionality placed upon the loan other than the natural due diligence ones to ensure that the government gets its money back. Moreover, Australia points out, the two contracts are independent. Even if the company had received only the first payment under the grant contract, the loan would have continued. Thus, regardless of what happens to production, the loan will continue, so long as the company meets the interest and repayment conditions.

7.9 According to Australia, Articles 3.1(a) and 4 of the SCM Agreement are clear that Article 3.1(a) of the SCM Agreement is about individual subsidies, not about an aggregation of subsidies. When examining whether a subsidy falls under Article 3.1(a) of the SCM Agreement, it is necessary to look at each subsidy separately, measure by measure. There is no issue of aggregation such as can arise under Article 6.1(a) of the SCM Agreement. Australia points out that:

- (a) the chapeau of Article 3.1 of the SCM Agreement refers to: "the following subsidies";
- (b) footnote 4 of the SCM Agreement refers to "the granting of a subsidy" and "[t]he mere fact that a subsidy is granted";

- (c) footnote 5 of the SCM Agreement refers to: “[m]easures referred to”; and
- (d) Article 4 of the SCM Agreement continually refers to individual subsidy programmes, e.g.: “a prohibited subsidy” in paragraphs 1, 5 and 7; “the subsidy” in paragraphs 2, 3, and 7; and “the measure in question” in paragraph 5.

7.10 Accordingly, Australia argues, the Panel needs to consider the status of each measure quite separately under Article 3.1(a) and footnote 4 of the SCM Agreement. The fact that an enterprise receives more than one subsidy does not mean that the status of one measure under Article 3.1(a) of the SCM Agreement has any implication for other measures. Again, there are other provisions under the SCM Agreement where a Member can seek remedy if it considers that there is adverse effect from the aggregation of a number of subsidies, i.e. under Parts III and V of the SCM Agreement. However, this case is limited to Article 3.1(a) of Part II of the SCM Agreement. There is nothing in the text that suggests, and the United States has made no argument, that the existence of a measure in breach of a WTO obligation automatically determines the status under the WTO of any other measure benefiting the same enterprise. In particular, regardless of what finding the Panel makes about payments under the grant contract (or the grant contract itself), the United States has made no allegation that the loan is in any way contingent upon performance, let alone export performance.

7.11 The **United States** submits that, in its request for the establishment of the Panel (WT/DS126/2), the United States identified the specific measures at issue in this case: “a A\$25 million preferential loan and grants of up to A\$30 million.” There are two contracts between the Australian government and Howe: a loan contract and a grant contract. The term “grants” includes any and all possible disbursements under the latter contract. That is why the measure is phrased in terms of “grants up to A\$30 million.” According to the United States, the measures that have been targeted in this case are therefore explicitly described in the panel request and Australia cannot claim that it did not have adequate notice in this case of the claims.

7.12 The United States argues that, contrary to Australia's assumption, the term “grants” does not serve to distinguish between actual payments and the grant contract. Rather, the term “grants” includes all possible disbursements, whether past or future, and otherwise serves to distinguish whether the funds were bestowed upon Howe pursuant to the loan contract or the grant contract. Nowhere in the request for consultations or the panel request is the term “grants” limited to actual payments. In the view of the United States, it is nonsensical to assume that the United States would pursue a dispute settlement complaint on only past payments made under a single contract and ignore any future payments that could be made under the same contract.

7.13 The United States contends that the Panel should reject Australia's argument that the only measures before the Panel are the A\$25 million preferential loan and two payments made pursuant to the grant contract. In the view of the United States, Australia's arguments are not supported by any reasonable interpretation of the panel request. The measures at issue include the loan contract and the grant contract. Under Article 7.1 of the DSU, the terms of reference of this Panel are to examine “the matter referred to the DSB in WT/DS126/2.” Pursuant to Article 6.2 of the DSU, in the request for the establishment of a panel in this case (WT/DS126/2), the United States identified the “specific measures at issue” as follows: “these subsidies include the provision by the Government of Australia to Howe of grants worth as much as A\$30 million and a A\$25 million loan on preferential and non-commercial terms.” The United States underlines that the request states that the measures include (1) *the provision* by the government of grants worth as much as A\$30 million; and (2) *a loan*. The ordinary meaning of the term “provision” is “the act or the instance of providing.”⁴⁸ The act or

⁴⁸ *The Concise Oxford Dictionary*, Clarendon Press, 8th ed., p. 962.

instance of providing the grants in this case was the single grant contract. Thus, the measures at issue in this case, as explicitly described in the panel request, include the loan contract and the grant contract. The United States emphasizes that the grant contract includes the government's commitments to make payments and captures any and all possible disbursements under that contract.

7.14 Regarding the grant contract, **Australia** asserts that it has a right under the DSU to be informed by the complainant about the precise measure on which it is being challenged and the legal reason for it being considered to be a subsidy. Australia maintains that it would appear from the questioning to the United States by the Panel, that the Panel also is not clear about the issue. It is inappropriate that the United States should only be making the issue unequivocal at a late stage of the Panel proceedings.

7.15 According to Australia, this issue is relatively unimportant under Parts III and V of the SCM Agreement, since the issue there is one of whether there is subsidization or not, and if so, how to calculate it. Under Part II of the SCM Agreement, the issue can be more fundamental to the process. In this case, Australia states, the complainant is required to prove that the granting of the particular subsidy in question is in fact contingent upon export performance. The elements of proof can be different depending on the measure that is at issue. For example, the facts and argument required to demonstrate such proof regarding the grant contract would be different from the facts and argument regarding the first A\$5 million payment.

7.16 With respect to the United States' assertion that "it is nonsensical to assume that the United States would pursue a dispute settlement complaint on only past payments", Australia states that this is not the issue. The issue is, rather, what were the measure or measures that the United States actually identified in its documentation. In this regard, Australia asserts that it is worth noting that the claims and measures are the same for the panels in both WT/DS106 and WT/DS126. However, the United States admitted that the request for consultations in WT/DS106/1 was inadequate in respect of Article 4.2 of the SCM Agreement. According to Australia, since that error in the United States' view was sufficient for it to force through the current Panel process, it would not be unreasonable to assume that there could well be other flaws in the documentation, (i.e. apart from the issue of disclosure under Article 4.2 of the SCM Agreement), including at least that the United States may not have requested what it wanted.

7.17 Australia disagrees with the reference by the United States to the request for the establishment of the Panel in WT/DS126/2. While the request for a panel may limit the scope of the Panel, it is not correct to argue that the request for the establishment of a panel can widen the scope. The original request for consultations (in this case WT/DS126/1) limits the scope. A panel cannot be established with a scope wider than that envisaged under the original request for consultations. In any case, in asking for "the establishment of a panel to examine the matter", paragraph 4 of WT/DS126/2 is referring to the matter covered by the consultations requested in WT/DS126/1 as set out in paragraph 3 of WT/DS126/2. Australia states that the act or instance of providing the grants is the provision of the tranches under the grant contract.

7.18 The **United States** argues, in the alternative, that if the Panel finds that one of the measures, i.e., the grant contract or the third payment thereunder, is not *explicitly* described in the panel request, the question becomes whether that measure is subsidiary, or so closely related, to a measure that is specifically identified, that the responding party can reasonably be found to have received adequate notice of the scope of the claims asserted by the complaining party. The United States refers to the following statement of the panel in *Japan - Measures Affecting Consumer Photographic Film and Paper ("Japan - Film")*:

To fall within the terms of Article 6.2, it seems clear that a ‘measure’ not explicitly described in a panel request must have a clear relationship to a ‘measure’ that is specifically described therein, so that it can be said to be “included” in the specified ‘measure.’⁴⁹

7.19 According to the United States, in the instant case, there can be no question that the grant contract itself and all payments made pursuant to the grant contract are subsidiary or so closely related to the measure described in the panel request that Australia received adequate notice that the United States was challenging the grant contract, including any and all possible payments under that contract. It is self-evident that the grant contract and the payments actually disbursed pursuant to the contract, whether past or future at the time of the panel request, are subsidiary or closely related to the measure described as “the provision by the Government of Australia to Howe of grants worth as much as A\$30 million.” Thus, even if the Panel does not agree that the panel request *explicitly* describes the measures as the loan contract and the grant contract, it is clear that the measures as described can be said to have “included” the grant contract itself and all payments made thereunder.

7.20 The United States asserts that Australia devotes considerable time to arguing that the measures described in the *consultation* request limit the United States to challenging only the first two payments under the grant contract. Putting aside the fact that the language of the consultation request cannot be reasonably construed to impose such a limitation, it is the *panel request*, not the consultation request, that is relevant for determining the scope of the measures before this Panel.⁵⁰ The panel request specifically identifies the measures at issue in this case to include the loan contract and the grant contract.

7.21 **Australia** disagrees with the interpretation made by the United States of paragraphs 10.8 and 10.9 of *Japan – Film*.⁵¹ The issue in this current dispute is not about the inclusion of a subsidiary measure. Under the DSU, a claim must be specified, the specific measures at issue must be identified, and there must be a brief summary of the legal basis of the complaint sufficient to present the problem clearly. This has not been done for this dispute. Ultimately, it is up to the Panel to decide whether the United States' request in WT/DS126/1 was sufficient to provide the basis for a “curing” of its claims in subsequent submissions.

7.22 The **United States** submits that, in any event, contrary to Australia's assumption, the term “grants” as used in the consultation request does not serve to distinguish between actual payments and the grant contract. Indeed, the *Concise Oxford Dictionary* notes that the term “grant” means the “process of granting or the thing granted.”⁵² Thus, the only reasonable interpretation is that the term “grants” includes both the government's commitment to make payments and the payments themselves, including all possible disbursements, whether past or future. Nowhere in the consultation request, or the panel request for that matter, is the term “grants” limited to past payments.

7.23 In **Australia's** view, the “definition” given by the United States of “grant”, i.e. “the process of granting or the thing granted”, contains alternative meanings. In WT/DS126/1 the United States talks of “grants of up to A\$30 million” (and in WT/DS126/2 of “grants worth as much as A\$30 million”). The plural of “the process of granting” is “the processes of granting”. Thus, on the basis of the first meaning the United States is apparently talking about “the processes of granting [of] up to A\$30 million”. Each of these *processes* must be in relation to an actual payment, since otherwise why not say “grant of up to A\$30 million” if that is the meaning attributed by the United States to “grant”? This would suggest that the Panel should look at each of the payments separately. The same

⁴⁹ WT/DS44/R, adopted 31 March 1998, para 10.8.

⁵⁰ *Ibid*, para. 10.9.

⁵¹ WT/DS44/R, adopted 31 March 1998.

⁵² *The Concise Oxford Dictionary*, Clarendon Press, 8th ed.

conclusion arises from using the second meaning “the thing granted”. “Grants” then becomes “the things granted”. Accordingly, “grants of up to A\$30 million” becomes “the things granted of up to A\$30 million.”

7.24 Australia underlines that the identification of what the complainant considers to be the subsidy is critical to the argument of whether the granting of that subsidy meets the “in fact” standard of Footnote 4 of the SCM Agreement. This goes to the heart of what the measures are before the Panel and the alleged “existence and nature of the subsidy in question”. Under Article 4.2 of the SCM Agreement, these were supposed to be identified in the complainant’s request for consultations.

7.25 In respect of the grant contract, Australia asserts that it remains unclear whether it is the grant contract that is the subsidy at issue or the individual payments under the grant contracts that are the subsidies at issue. This is central to what the United States must prove.

7.26 According to Australia, if it is the grant contract, then the issue is whether the granting of the grant contract was in fact tied to actual or anticipated exportation or export earnings. Of course, the two cases do overlap, since the way in which the actual grants are made go to the demonstration of the nature of the grant contract itself. The bases for the actual payments under the grant contract have necessarily to be looked at to see what was in fact agreed between the Australian government and the company. The record confirms conclusively that the payments were not tied to actual or anticipated exportation or export earnings. This, in turn, proves that the granting of the grant contract was not in fact tied to actual or anticipated exportation or export earnings. Australia reasons that, if, on the other hand, it is the individual grants under the grant contract, the granting of each of them must be considered separately. Trivially, the first tranche was only tied to the execution of the grant contract and to nothing else. Given the bases for the second and third tranches, there were clearly no ties to export performance.

B. NATURE OF THE EVIDENCE PRESENTED

7.27 **Australia** has serious systemic concerns about the nature of those United States exhibits where the United States has chosen to use inter-governmental communications, without consultation with Australia. However, Australia recognizes that this is not an issue for the Panel except where the provenance has not been provided by the United States and the presentation may even be misleading.⁵³ On the other hand, it is important that the Panel address the issue of what cognizance it should give to media reports and other comments by private parties, including the company, in assessing governmental actions and decisions. Australia submits that the Panel should place little or no weight upon such exhibits, or at least take great care about assessing their probative value.

7.28 As an example of the risks of making misrepresentations of factual material, Australia points to a specific paragraph in the United States’ submissions to the Panel.⁵⁴ In Australia’s view, these numbers do not bear on the matter before the Panel. However, the United States has chosen to compare unlike situations here. Until Howe was bought by ALH in 1994, it also produced furniture leather. A reorganization within the group of companies resulted in Howe dealing only with the group’s automotive leather business. Before the reorganization, Howe used to export more than

⁵³ Australia refers to a specific United States exhibit. See its arguments *infra.*, para. 7.196.

⁵⁴ This paragraph states:

"These subsidies have led Howe to dramatically change its sales patterns. In the late 1980s, exports accounted for less than 10% of its total sales; by 1997, exports comprised 90 percent of Howe’s sales. In addition, and as described in more detail below, the Australian government’s current replacement package for Howe is designed to subsidize the modernization and expansion of Howe’s production capacity, so that it can more effectively compete in international markets and continue its rapid export-led growth."

three-quarters of its automotive leather production. Given the growth in the global market for automotive leather both in Australia and in many other larger markets, it is not surprising that Howe's production has increased and that its sales to overseas markets have also increased. Australia states that business confidential information it provided to the Panel regarding Howe's sales figures over the period 1995/96 to 1997/98 showed that exports of automotive leather represented a significantly lower share of Howe's total sales in this period than suggested by media and other reports cited by the United States.

7.29 The **United States** asserts that it is worth noting that although Australia questions the probative value of media articles, it has not specifically disputed any of the information the United States has obtained from those articles.

7.30 The United States argues that Australia fails to counter any of the United States' factual evidence (such as Howe's current or anticipated exports or the small size of the Australian automotive leather market) with facts that would undermine their credibility. In fact, Australia does not even deny their truthfulness. Instead, Australia questions the probative value of relying upon newspaper and other media articles. However, it is entirely appropriate to rely on media articles in the absence of other inconsistent information. In fact, the evidence before the panel in *Indonesia - Certain Measures Affecting the Automobile Industry*⁵⁵ included information from newspaper articles. Although Australia argues that the statements by Australian government officials which appear in the press should be considered in their proper domestic political context, Australia does not offer any evidence rebutting the statements quoted from the media releases and articles.

7.31 The United States asserts that the Panel should note the variety and volume of sources relied upon by the United States in this case. The United States has not just cited one isolated newspaper article; it has offered a range of articles from well-respected newspapers to industry magazines. They all have the same theme: Australia provided replacement subsidies to Howe to support its export drive. Furthermore, the information obtained from the media articles was consistent with other sources presented, including press releases from the Australian government.

7.32 **Australia** does not accept this characterization of its position by the United States. The fact that Australia has not commented on each of the media articles and other such exhibits does not mean that it accepts the conclusions that the United States has drawn from them. In particular, Australia does not accept that these media reports, with selective quotes and journalistic commentary, represent any sort of evidence of the rationale for Australian government decisions on trade and industry policy issues.

7.33 Australia assumes that the media reports are accurate citations.⁵⁶ But all that they represent are interpretations by the media. In Australia, as in most, if not all, countries, being internationally competitive and a successful exporter is seen as being admirable. Comments attributed to ministers and officials need to be taken in their proper domestic political context, where terms are not being used with the same meaning and precision as in the context of the WTO. It is commonplace for comments to focus on success in selling in foreign markets. However, that is not the same as saying that industry arrangements favour exports, or that in this case the comments represent evidence that the recognized purpose of the measures in question were to favour exports, or are in any way "in fact tied" to export performance.

7.34 Australia states that where quotations are cited they are necessarily selective (as are often the United States excerpts) and were, no doubt, given in quite different contexts. The ubiquitous "former senior official" is often quoted in the media without any level of authority (or current knowledge). It

⁵⁵ WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R, adopted 23 July 1998, para. 4.107.

⁵⁶ Although Australia also refers to its arguments *infra*, para. 7.196.

would hardly be a productive exercise, and of no value to the Panel, for Australia to try to track down the journalists and people interviewed and try to obtain from them what they had in mind at the time and what they thought their comments would mean in terms of footnote 4 of the SCM Agreement. Many of those interviewed presumably would be protected by journalistic confidence. If such exhibits are to be considered at all, they would need to be treated with great caution, since by their very nature they do not represent the views of government and are hardly in the realm of facts. The Panel's obligation under Article 11 of the DSU is to "make an objective assessment of the matter before it, including an objective assessment of the facts...." In Australia's view, relying on, and drawing factual conclusions from, such sources in any way would not be consistent with this obligation.

7.35 Against this background, Australia raises specific comment on some of the United States exhibits. For example, the United States purports to quote the Australian Deputy Prime Minister, Tim Fischer, as saying: "by dint of effort, we [the Australian government] have ensured that Howe Leather has been able to continue its export activity over the last 18 months." This quote is from a newspaper article of 29 September 1997 included in the United States exhibits.⁵⁷ There are a couple points that are worth making. First, the references to "export activity" and "the last 18 months" are for the period from the launching of the section 301 case in the United States and refer to preserving the right of Howe to sell to its United States customers, where clearly the petitioners did not want the original equipment manufacturers (OEM) market for automotive leather to be contested by non-US firms. This was about maintaining market access to the world's largest market for automotive leather in the face of the dispute with the United States, not about export subsidization. Secondly, the purported quotation goes on to say that this was done "while honouring all of our WTO commitments." The quote in the article also said that the new arrangements "fully complied with all the elements of the agreement reached with the US last year." If the United States chooses to introduce selective quotations as somehow representing "evidence" of the "recognized purpose" of the Australian government, it should choose such quotations more carefully, as read in full they leave no doubt that the government had no intent of introducing prohibited export subsidy arrangements.

7.36 The United States points out that the 18-month period referred to by Trade Minister Fischer included the six month period from April to September 1997. This was after the replacement package became operative.

7.37 Similarly, **Australia** continues, there is the media release by the Australian Minister for Industry, Science and Tourism, John Moore, of 27 December 1996⁵⁸ where Mr Moore says that: "The package safeguards the jobs of around 500 employees and will ensure that Howe and Co. can continue to invest and grow as planned." This again underlines that the government's focus was not on some sort of circumvention arrangement in respect of export subsidies, but the much more immediate domestic task of maintaining jobs in disadvantaged regional areas, through WTO-consistent means.

7.38 In the same vein, Australia continues, Howe and its parent company did not make public comments in the context of the WTO Agreement. Presumably, when they commented in annual reports, they simply sought to inform their shareholders about their current commercial prospects, as they are required to do by domestic law. However, again this has no bearing on issues concerning footnote 4 of the SCM Agreement, and the legal issues involved in this case. The views of companies on trade policy or related legal issues that they would often find arcane are not relevant to the consistency, or otherwise, of government measures.

⁵⁷ "Fischer vows to fight US trade challenge", The Australian, September 29, 1997, United States Exhibit 45.

⁵⁸ Commonwealth Government safeguards Howe jobs", Media Release, December 27, 1996, United States Exhibit 2.

7.39 As one final example, Australia considers the quote that ‘Howe’s then Managing Director stated that he had been “assured” that Howe “would be compensated with an alternative arrangement that would help it continue to expand exports”’.⁵⁹ This needs to be put in context. This is a company that had been affected by a section 301 case in one of its major markets. The Managing Director was hardly going to send the wrong signal to potential customers. In the reality of the market-place, he had to confirm that the company was in business for the long haul in the United States market. The article implies that he did not know the details of the arrangements between Australia and the United States and clearly he did not know what the new arrangements would be. Indeed, how could he since they had not been designed, much less finalized, at that time. The sense of the article is that the Managing Director also recognized the need for any such assistance to be “within the WTO rules”.⁶⁰ These are not the comments of someone being told that a covert scheme would be crafted. But rather it is a story about a firm that the government has said it would not abandon as a result of cutting automotive leather out of two entitlement schemes. That would be the plain reading interpretation of that article. As Australia has already stated, press articles are not government policy documents and are not always accurate in terms of facts, representation of individuals’ statements and the spin given to a story by the author. Nevertheless, Australia asserts, the full context of the quotes clearly illustrates that WTO-consistency was an essential parameter for any new assistance arrangements for the company.

C. ARTICLE 1 OF THE SCM AGREEMENT

1. "financial contribution"

7.40 The **United States** notes that, before addressing whether the measures in question constitute subsidies "contingent ... in fact upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement, the Panel must first consider whether the measures fall within the definition of "subsidy" under Article 1 of the SCM Agreement.

7.41 The United States alleges that the assistance bestowed on Howe by the Australian government constitutes subsidies under Article 1 of the SCM Agreement. The Australian government directly transferred two significant sums of money to Howe, one in the form of a grant and the other in the form of a preferential loan. The United States observes that Article 1.1(a)(1)(i) of the SCM Agreement expressly states that both “grants” and “loans” qualify as “financial contributions” by a government. Accordingly, the United States contends, the Australian government cannot dispute that the A\$30 million grant and the A\$25 million preferential loan provided to Howe constitute financial contributions within the meaning of the SCM Agreement. ”

7.42 **Australia** submits that the loan is a subsidy under Part I of the SCM Agreement, without prejudice to issues such as calculation and its status under other parts of the SCM Agreement. Australia also states that the payments under the grant contract are subsidies within the meaning of the SCM Agreement. However, Australia submits that the United States has not demonstrated that the grant contract is a subsidy, even though, on at least due process grounds, it should have been required to do so in its first written submission to the Panel. Australia underlines that it agrees with the United States that the “grants” ... qualify as “financial contributions” by a government’. However, the United States then jumps to “the grant” conferring a benefit, which could be a reference to the grant contract, or could possibly be a reference to each of the individual grants referred to in the previous paragraph. Even assuming for the sake of argument that the reference is to the grant contract, the

⁵⁹ "Melbourne firm could lose in U.S. subsidies deal", The Age, November 25, 1996, p. 1, United States Exhibit 15.

⁶⁰ *Ibid.* Australia cites the following phrase: “He said that he did not know what else the US companies would have to complain about if an alternative arrangement was found that was within WTO rules.”

United States did not demonstrate the nature of the "financial contribution", as required for defining a subsidy.

7.43 The **United States** notes Australia's assertion that the United States has not demonstrated that the grant contract itself is a subsidy. This is a dubious distinction. The grant contract is not a separate measure from the payments made pursuant to the contract. The grant measure at issue in this case is the Australian government's commitment to make grant payments to Howe, which subsumes the disbursements themselves. A legally enforceable promise by the government to provide funds constitutes an asset that Howe may rely upon in its business planning. As such it is a "financial contribution" that confers a "benefit" within the meaning of Article 1 of the SCM Agreement.

7.44 Furthermore, the United States asserts, if a party had to wait until the subsidy is paid out to challenge it, such a requirement would have the effect of eviscerating the SCM Agreement's disciplines for prohibited subsidies.

2. "benefit"

7.45 The **United States** notes that to qualify as a "subsidy" within Article 1 of the SCM Agreement, the financial contribution must have conferred a "benefit". With respect to the grant, the benefit is self-evident: Howe has been given government money that it need not repay. The Australian government has provided Howe with a free source of capital that can be used to improve its productivity, decrease its labour and material costs, improve the quality of its automotive leather, lower its prices and generally enhance its competitiveness. Based upon an allocation of the benefits received, the total benefits conferred on Howe in 1998 were A\$31,977,692.71.⁶¹

7.46 While the United States observes that a loan obviously differs from a grant in that it eventually must be repaid with interest, the United States asserts that there are several indications that the A\$25 million loan at issue also conferred a "benefit" upon Howe. These include:

(a) The Five Year Holiday on Principal and Interest Payments Confers a "Benefit"

7.47 The United States contends that, under the terms of the loan, Howe is not required to pay principal or interest for the first five years, nor does interest accrue during this period. According to the United States, this is a valuable benefit to Howe. First, there is a substantial savings to Howe of the interest that it would have paid in the absence of the holiday. Using the interest costs that Howe's parent incurred for commercial borrowings as a benchmark, Howe saved approximately A\$8,700,000 over the five-year period in interest payments.⁶² Howe also received the additional benefit of being able to invest this money. For example, if Howe had invested the money in Australian government long-term bonds (a conservative illustration), Howe would have earned a total of A\$8,625,000 over the five year period.⁶³ Accordingly, the total benefit to Howe conferred by the five year holiday on principal and interest payments based on a Australian government bond rate of 6.89% equals A\$17,325,000.⁶⁴

(b) The Loan Provided Howe with Credit Terms More Favorable Than Those Howe Could Have Obtained Commercially

7.48 The United States alleges that, in addition to supplying Howe with an interest-free loan for five years, the Australian government also provided Howe with credit terms more favorable than

⁶¹ United States Exhibit 50. See *infra*, para. 7.55 for a description of this Exhibit.

⁶² United States Exhibit 51. See *infra*, para. 7.56 for a description of this Exhibit.

⁶³ *Ibid.*

⁶⁴ *Ibid.*

those it could have obtained commercially. The loan given to Howe reflects a preferential interest rate that, at the very least, the borrower would have to be creditworthy to receive. Yet, the United States argues, for a significant part of the past decade, Howe's financial condition has been precarious. In its fiscal year ending 30 June 1997, Howe's parent company, Australian Leather Upholstery Pty. Ltd., experienced a loss of A\$6.9 million, which was attributable to Howe's poor financial performance.⁶⁵ Howe's parent also reported a A\$2.6 million loss in the prior fiscal year, 1995/96.⁶⁶ These financial difficulties are also reflected in the public statements of Schaffer, the holding company for Howe's parent corporation. In its 1996 Annual Report, Schaffer reports that 1995-96 was a "difficult year for the automotive leather business" and that Howe's "poor manufacturing performance was a big disappointment" resulting "in a similarly substantial negative turnaround."⁶⁷ Such a track record was not unusual for Howe: in fiscal year 1993, it lost A\$2.4 million⁶⁸ and in fiscal year 1989, it lost A\$3.7 million.⁶⁹

7.49 According to the United States, Howe's troubled financial history was well-known and widely acknowledged. For instance, the United States points out, a 1998 press report highlighted "the need for management changes to improve Howe's position and 'stop the red ink.'"⁷⁰ Similarly, another press article emphasized that Howe "would have dipped into losses in 1997 without the substantial contribution it accrued from trading in import credits."⁷¹ Indeed, the Australian government has publicly acknowledged that depriving Howe of export assistance could sound the company's death knell. For instance, Minister John Moore characterized the replacement subsidies as "the minimum required (and confirmed by independent international auditors) for Howe to remain viable."⁷²

7.50 In the view of the United States, these financial statements, press reports and government releases confirm that Howe was in deep financial trouble at the time of the loan. It thus appears unlikely that Howe would have been able to secure a 15-year loan amounting to approximately one-fourth of its total sales volume from any commercial lender and most certainly not on terms that even financially stable borrowers would find favorable. If Howe had been able to get a 15-year loan in its then-current state, the lender most likely would have required substantial collateral and would have charged an interest rate that was higher than the rate given to creditworthy companies. Yet, despite Howe's unprofitability, the Australian government not only gave Howe a loan, it provided preferential interest rates. The cut-rate financing is evident by comparing the interest charged Howe's holding company on its non-government loans and the rate the Australian government charged Howe in its new aid package. As of June 30, 1997, ALH reported A\$31,373,000 in consolidated borrowings and

⁶⁵ Australian Leather Holdings Limited, Financial Statements, June 30, 1997, pp. 20-21, United States Exhibit 26. According to the United States, the financial statements reveal that Howe is likely the most important company within the Australia Leather Upholstery Pty. Ltd. group. Besides Howe, the group includes Howe & Co. (SA) (Pty.) Ltd. located in South Africa, Howe de Mexico SA de CV located in Mexico, and ALH Staff Superannuation Pty. Ltd. *Ibid.* at 20. The footnotes to this list indicated that the ALH Staff Superannuation Pty. Ltd. meets the definition of a small proprietary limited company as set out in the Corporations Law. *Ibid.* The financial statement also notes that the operations in South Africa and Mexico do not have a material effect on the accounts. *Ibid.* at 32. Thus, the United States asserts, the financial results identified for the Australian Leather Upholstery Pty. Ltd can reasonably be attributed to Howe's operations in Australia.

⁶⁶ *Ibid.*, pp 20-21.

⁶⁷ Schaffer Corporation, Annual Report 1996, pp. 2-3, United States Exhibit 34.

⁶⁸ Howe Leather, 1993 Annual Return, March 29, 1994, p. 2, United States Exhibit 35.

⁶⁹ Howe Leather, 1990 Annual Return, May 21, 1991, p. 5, United States Exhibit 36.

⁷⁰ "Australia: Leather Company's Hide Wearing Thin," Australian, February 2, 1998, United States Exhibit 37.

⁷¹ "Sacred Cows vs. The Hide of Howe," The Weekend Australian, September 20-21, 1997, p. 52, United States Exhibit 22.

⁷² United States Exhibit 18.

A\$3,647,000 in consolidated interest and other finance charges.⁷³ Based upon this information, the company's interest rate for its current borrowings was 11.62 per cent. In contrast, the A\$25 million loan given to Howe was based on the government's long-term bond rate, which averaged 6.89 per cent for 1997, the year the loan was granted.⁷⁴ Adding two percentage points to this rate, as required by the terms of the loan, the interest on this loan would only be 8.89 per cent, or approximately three percentage points below the company's rate based upon its then-current borrowings. This results in saved interest payments, which clearly confer a benefit upon Howe.

(c) The Loan Is Not Adequately Secured

7.51 The United States alleges that a final indication of the beneficial nature of the A\$25 million loan is the fact that it is not adequately secured. The loan appears to be secured by a second mortgage over the assets and undertakings of Howe's parent corporation, ALH.⁷⁵ However, the United States argues, a second mortgage of this nature would be inadequate for a commercial loan of this size and duration. For instance, Morgan Brooks Pty. Ltd. of Australia requires "[a] registered first mortgage over commercial, industrial, retail or residential investment real estate" for its commercial mortgages. In this instance, however, neither ALH nor Howe could have provided a lender with a first mortgage, since ALH's other borrowings -- namely, its bank overdraft account, its commercial bills payable account, and a bank loan -- appear to already have been encumbered by a first mortgage "over all the assets and undertakings" of ALH.⁷⁶ Accordingly, the United States submits, the fact that the government of Australia did not require Howe to pledge adequate security before extending the A\$25 million loan constitutes yet another way in which the Australian government has conferred a "benefit" on Howe.

7.52 **Australia** submits that the loan is a subsidy under Part I of the SCM Agreement, without prejudice to issues such as calculation and its status under other parts of the SCM Agreement.⁷⁷ Australia also states that the payments under the grant contract are subsidies within the meaning of the SCM Agreement. It is up to the United States, rather than Australia, to demonstrate that the grant contract is a subsidy, and for Australia to respond to that. The United States appears not to have made such a demonstration, even though, on at least due process grounds, it should have been required to do so in its first written submission to the Panel.

7.53 While it is not relevant to the issue in Australia's view, Australia believes that it may be worthwhile commenting on the United States point about Howe being in financial trouble.⁷⁸ The evidentiary value of the facts put forward by the United States is highly questionable, but in any case they do not demonstrate this. There are many highly creditworthy companies that have short term and even long term losses. In Howe's case, an assessment of its creditworthy position would involve an analysis of Howe itself, its parent company and its ultimate controllers. It would involve an assessment of the creditworthiness of all of these entities. If this was a genuine concern of the United States at the time, why did it insist that the grant contract money be devoted largely to investment?

⁷³ Australian Leather Holdings Ltd, June 30, 1997 Financial Statement, December 5, 1997, pp. 7, 9, United States Exhibit 26.

⁷⁴ United States Exhibit 53.

⁷⁵ Australian Leather Holdings Ltd, June 30, 1997 Financial Statement, December 5, 1997, p. 24, United States Exhibit 26.

⁷⁶ *Ibid.*, p. 23.

⁷⁷ Australia disputed the calculation issues raised in this section. See the arguments of Australia *infra*, paras. 7.57-7.59 and 7.62-7.72.

⁷⁸ *Supra*, paras. 7.48-7.50.

7.54 The **United States** observes that Australia confirmed that it does not dispute that the loan and the grant fall within the definition of "subsidy" in Article 1. In addition, Australia concedes that the loan was on concessional terms. With respect to Australia's assertion that the United States has not demonstrated that the grant contract itself is a subsidy, the United States maintains that the grant measure at issue in this case is the Australian government's commitment to make grant payments to Howe, which subsumes the disbursements themselves. A legally enforceable promise by the government to provide funds constitutes an asset that Howe may rely upon in its business planning. As such it is a "financial contribution" that confers a "benefit" within the meaning of Article 1 of the SCM Agreement.⁷⁹

3. calculation and allocation of the "benefit"

7.55 As noted in paragraphs 7.45-7.51 above, the **United States** made submissions relating to the calculation and allocation of benefits conferred upon Howe under the grant contract and the loan contract. With respect to the grant contract, the United States referred to its Exhibit 50. With respect to the loan contract, the United States referred to its Exhibit 51. A brief description of these exhibits follows. United States Exhibit 50 is a table entitled "Allocation of Benefits from Grants Received by Howe and Co. Pty. Ltd." It has four main columns. The first lists the years 1997-2010, based upon an "estimated useful life of assets for Howe of 13 years". The second main column is headed "A\$17,500,000 Grant Provided in 1997". The third main column is headed "A\$12,500,000 Grant Provided in 1998". Both of the second and third columns are subdivided into two sub-columns: (i) "Unamortized Portion of Grant"; and (ii) "Interest Saved on Unamortized Portion". According to the United States, the latter is "calculated by multiplying unamortized amount of grant in given year by 11.6 per cent, which represents the interest rate Howe would have paid to finance the capital investment absent the grant. The interest rate was derived from information contained in the 1997 financial statement of Australian Leather Holdings, Ltd. (ALH), Howe's parent company. According to the statement, ALH's consolidated borrowings (A\$31,373,000) divided by consolidated interest and other finance charges (A\$3,647,000) yields an interest rate of 11.6 per cent for borrowings in 1997." The fourth main column of the table is headed "Total of Grants Provided". According to the United States, "Total benefits equal total unamortized portion of grant plus total interest saved on unamortized portion in given year (i.e., in 1999, benefits equal A\$26,346,154 + A\$3,056,154 = A\$29,402,308)."

7.56 United States Exhibit 51 is a table entitled "Benefit to Howe Based Upon Repayment of \$25 Million Loan After Five Years". It has four columns. The first column lists the years 1998-2002. The second column is entitled "Interest Saved". According to the United States, this refers to "Interest saved because of five-year interest holiday". The benefit is calculated as interest savings on remaining principal (outstanding principal x 11.6 per cent). The interest rate was derived from information contained in the 1997 financial statement of Australian Leather Holdings, Ltd. (ALH), Howe's parent company. According to the statement, "ALH's consolidated borrowings (A\$31,373,000) divided by consolidated interest and other finance charges (A\$3,647,000) yields an interest rate of 11.6 per cent for borrowings in 1997." The third column in the table is entitled "Interest Earned". The United States explains that this refers to "Interest earned on A\$25 million. Annual interest equals A\$25 million x 6.9% (average GOA bond rate in annual 1997)." The fourth column is entitled "Total", and lists the totals of columns 2 and 3 for the years 1997-2002. It then adds all of these totals, resulting in a sum of A\$17,325,000.

7.57 **Australia** points out that, with respect to the benefit conferred by the loan⁸⁰, the United States makes some sweeping assumptions about the way a subsidy might be calculated in the context

⁷⁹ Also see arguments of the United States, *supra*, paras. 7.43-7.44.

⁸⁰ See the arguments of the United States *supra*, paras. 7.45-7.51.

of Part II of the SCM Agreement, regarding benefit to the recipient and allocation over time.⁸¹ According to Australia, the issue of calculation and allocation of the measures is not before the Panel (that is, beyond the question of whether each of the measures before the Panel is indeed a subsidy). Accordingly, the Panel should not make any findings or suggestions on calculation and allocation issues.

7.58 While Australia maintains that calculation issues are not relevant to the Panel, Australia nevertheless asserts that the United States has grossly exaggerated the extent of subsidy provided by the loan, including the benefits in the first five years. This is not a case about United States countervailing duty methodology. For example, the United States⁸² uses a method of determining the level of subsidy from a loan (which it describes as a conservative illustration), which assumes that the money is invested in government bonds. Clearly, in that case, the benefit to the company would be just the returns from the bonds.⁸³ No company would borrow at a high interest rate to invest at a lower one. It makes no economic sense to add the second and third columns in the table in United States Exhibit 51 to calculate the level of subsidy, since this is just double counting.

7.59 On the actual calculation of benefits under the grant contract, again as with the loan, this is not a case about United States countervailing duty methodology. Few, if any, other jurisdictions would, in an allocation scenario, add the total unamortized portion to the interest saved and call that the annual benefit. This leads to the calculated benefit from the potential maximum payments of A\$30 million over 1996/97-1998/99 (July/June) as being A\$31,977,692 in 1998 alone. The sum of the calculated annual benefits derived from the unamortized payments, excluding interest payments, comes to A\$210 million in the table in United States Exhibit 50. This is seven times greater than the A\$30 million cap on payments.

7.60 The **United States** notes that Australian government contends that the calculations "grossly exaggerate" and erroneously calculate the amount of benefit provided. Australia has misconstrued the United States' calculations for the benefits conferred by the grant and loan. With respect to the grant, the Australian government suggests that the United States is claiming that the total benefit provided for the A\$30 million grant is A\$210 million. That is not correct. The total "value" of the benefit to Howe in 1998 was A\$31,977,692. However, these benefits are *not* intended to be cumulative. The United States did not suggest that the annual benefit for each year would be added together to arrive at a "total benefit", as the Australian government suggests. Rather, these calculations represent the "value" of the benefit *in each particular year*. As the table in United States Exhibit 50 shows, the value of the benefit declines gradually over time.

7.61 With respect to Australia's contention that the benefit conferred by the loan has been miscalculated, the United States submits that, again, Australia has misconstrued the benefit calculations. These calculations reflect the fact that Howe received a double benefit when it received a preferential loan with a five-year interest holiday. First, column two in United States Exhibit 51 represents the interest that Howe would have had to pay if Howe could have secured a commercial loan for A\$25 million to finance its capital expenditures. Because Howe was not required to repay any interest for five years, it obviously received a benefit from this five-year holiday. The higher interest rate used in this column reflects the rate at which Howe would have had to borrow funds, based on the company's financial statement. The Australian government has provided no evidence to

⁸¹ Australia refers to *supra.*, paras. 7.46-7.51 and to United States Exhibit 51, which is described *supra.*, para. 7.56.

⁸² Australia refers to the United States argument in *supra.*, para. 7.47, and to United States Exhibit 51, which is described *supra.*, para. 7.56.

⁸³ Australia refers to the third column in the table in United States Exhibit 51. Australia states that this accepts solely for the sake of commenting on this calculation the use of the zero interest rate rather than allocating the 2% premium interest paid over the last ten years of the loan.

suggest that Howe's borrowing rate would be lower. In fact, its actual rate could have been considerably higher in light of its financial difficulties. The third column reflects the interest that Howe could have earned on A\$25 million if it invested this money. If, as Australia suggests, Howe's investment yielded a higher return than the government bond rate, then the benefit to the company was even larger. In other words, the United States' use of the bond rate was a conservative estimate of Howe's return. Combining these two columns does not "double count" the same benefit because Howe was in fact receiving a double benefit. First, unlike a regular commercial loan, Howe is not required to pay back any interest for the first five years, as it would have had to do if it had borrowed money at a commercial rate. Thus, it is receiving the benefit of a five-year interest-free period. The benefit from the interest-free period is reflected in the second column. Moreover, Howe was given the money to use, and thus received a benefit from this receipt of funds. The benefit received from having access to these funds is reflected in the third column. Thus, the United States properly cumulated these two benefits to derive the full measure of the benefit from the loan for the first five years of the loan.

7.62 **Australia** continues to disagree with the United States calculations in United States Exhibits 50 and 51 even for countervail or other purposes. The United States clearly misunderstood the points that Australia made. The fact that Australia makes these comments should not be taken to imply that Australia accepts any aspect of the United States' approach in respect of the grant or loan contracts.

7.63 In respect of the grant contract, Australia observes that the United States confirms that the last column of its Exhibit 50 is supposed to set out the computed benefit in each year of the total possible payments under the grant contract. It is unclear what the United States means when it says that "these benefits are not intended to be cumulative." Benefits of allocation of subsidies must be in some sense cumulative, subject to present value considerations, otherwise the concept is meaningless. Australia contends that the figures of A\$19,530,000 and A\$31,977,692 for the benefits in 1997 and 1998, respectively, far exceed the total potential payments. However, Australia does agree with the implication of the first two rows that the potential payments have been totally expensed in the periods for which they would be received.

7.64 In respect of the loan contract, Australia asserts that the concept of benefit is based on the idea that enterprises borrow money to do something with it. The benefit for countervail purposes of a government loan is based on the difference between what the government charges and the comparable commercial rate (alternatively the borrowing cost of the government for a cost to government calculation). The benefit from the subsidy has nothing to do with what the enterprise does with the money so long as it is free to do what it wants with it. An enterprise that borrows commercially has exactly the same capacity as an enterprise benefiting from a government loan to use borrowed money to generate income.

7.65 Australia submits that the calculations in United States Exhibits 50 and 51 and the related arguments, while irrelevant to the current case, were wrong. According to Australia, the United States has not disputed this. Nor has it explained the disconnect between its approach to the allocation of the grants over time and its claim that they are tied to export performance. The specific period of the grant contract is to mid-2000 -- no longer. The payments under the grant contract were based on reports for the period to mid-1998. If they were tied to export performance, then they became exhausted after the time period for those exports. Alternatively, under the logic of the United States' case about replacement measures, subsidies should be allocated across the period for the schemes they are supposedly replacing, i.e. through to mid-2000 or at most end-2000. Although irrelevant to this case, the allocation across lengthy periods on the basis of investment underlines that the United States in reality does not see any linkage between the measures and export performance.

7.66 In addition, Australia asserts that the United States' position on the issues of calculation and allocation inherently contradicts aspects of its argument on the issue of "contingent ... in fact" under Article 3.1(a) of the SCM Agreement. In the case of the loan, the United States first looks at the value of the loan over the period to 2002 and also at the rest of the loan period when referring to more favourable credit terms.⁸⁴ The United States has argued that the measure is a replacement for a programmes that ran until 2000 (30 June 2000 for ICS and 31 December 2000 for EFS) and that this in some way taints the replacement measures. It is arguing here about the benefits this measure allegedly provides the company over a fifteen year period, with even the first five years extending beyond 2000. An export subsidy must be tied, attached in some way, ("in law or in fact") to exports. Exports in turn must have, or be going, to occur in some particular period for the discipline to have any meaning. Australia argues that the United States has not produced any facts that demonstrate that the loan should be considered to fall under Article 3.1(a) of the SCM Agreement. Its argument seems to be based solely on an association between the loan contract and the grant contract.

7.67 Australia also notes that the United States has allocated payments under the grant contract across the period to 2009 for the first two payments (i.e. those measures before the Panel) and 2010 for the total potential payment in 1998/99.⁸⁵ As in the case of the loan, this gives rise to inconsistencies in the United States' arguments. The facts presented by the United States state that the performance targets, investment and sales, are limited to the period to 2000, i.e. the grant contract only covers the period to 2000. Indeed, the United States' arguments about the grant contract's relationship with ICS and EFS turn on it being for the same period as the company would have attracted entitlements under those plans, i.e. mid-2000 and end-2000, respectively. However, United States Exhibit 50 seeks to allocate the first two payments and the residual potential payment over a thirteen-year investment period to 2010. The United States has not even made an allegation, let alone produced any facts, that there is any connection made by the Australian government to any form of performance after 30 June 2000. By allocating the entire A\$30 million over an investment period, the United States appears to be arguing that none of the money paid out should be attributed to sales. On that basis, presumably no weight should be put on any of its arguments regarding linkages between payments and sales requirements.

7.68 Australia maintains that the United States is seeking to have it both ways through making an allocation across time as if for countervailing or possibly consideration of investment subsidies for the purposes of Article 6.1(a) of the SCM Agreement. Whatever relationship the second and third grant payments bore to any sales, those sales would have essentially gone. The United States argues that the grant contract is a substitute for ICS and EFS, over the remainder of their duration, but they both terminate in 2000, not in 2010. According to Australia, the reality is that the United States is focusing on a serious prejudice case, not a case under Article 3.1(a) of the SCM Agreement.

7.69 Australia asserts that the "in fact" condition in Article 3.1(a) of the SCM Agreement is there to deal with circumvention cases where a government provides money contingent on export performance but does so in a manner other than through legislation or legal contract. It is not there as a trade effects test, which would have to be assessed on a case-by-case basis. The United States has not produced or alleged that the contract involves circumvention. Rather, it relies on economic tests and arguments.

7.70 Australia asserts that the work under Annex IV of the SCM Agreement to elaborate calculation issues for Article 6.1(a) of the SCM Agreement involves a merger of the cultures of the multilateral remedy and countervail. A number of Members have some problems with aspects of

⁸⁴ Australia refers to *supra*, para 7.47 and to United States Exhibit 51, which is described *supra*, para. 7.56.

⁸⁵ Australia refers to *supra*, para. 7.45, and to United States Exhibit 50, which is described *supra*, para. 7.55.

this. However, regardless of the merits of that work on allocation, there is nothing under Article 3.1(a) of the SCM Agreement that would allow such an allocation across time for the purposes of this rule. Article 3.1(a) is about actual exports. If a Member provided export subsidies, for the sake of example, assume that these were straightforward export subsidies contingent in law upon the export of 100 widgets. The measure would no longer be in place once those 100 widgets had been exported. The condition would no longer have any force. It would be absurd to suggest that somehow future activities of a company were tainted because past performance had been subsidized. This is not an issue for Part II of the SCM Agreement. It may be an issue for Part III, i.e. serious prejudice, but that would depend on the circumstances.

7.71 Australia argues that the United States, by presenting the measures as being allocated across time, is accepting that there is no linkage between the granting of the measures and export performance. Thus, the United States is implicitly accepting that the measures do not meet the “in fact” standard of Article 3.1(a) of the SCM Agreement and are consistent with that Article.

7.72 Of course, Australia continues, in many instances, there may be no remedy at all for a past measure, certainly not under Part II of the SCM Agreement. This is in keeping with GATT/WTO practice. It is important that there not be some confusion between the retrospectivity of serious prejudice cases and countervailing duty action, and normal rules under the WTO. If a tariff is found to be in breach of a binding, then the remedy is to bring it into conformity. It is not to go back and find all the importers of record who may have paid too much over whatever period the tariff was in force. In Australia's view, the job of the dispute settlement system is to obtain consistency, not retrospective compensation or penalty.

7.73 The **United States** asserts that it provided the subsidy calculations to demonstrate, as a preliminary matter, that the grant and loan did confer a benefit upon Howe. However, the Australian government has misinterpreted the United States' argument with respect to the calculation of the benefit. Australia suggests that the method used by the United States to value the benefit is inconsistent with the United States' position that these benefits were tied to exports. The method used to calculate the value of the benefit is not directly related to the question of whether a subsidy is, or is not, an export subsidy. The calculation methodology and the legal and factual criteria for “in fact” subsidies are not interchangeable. Rather, the calculation methodology simply reflects the common sense inference that a benefit received from a grant or a preferential loan will extend well beyond the precise moment that the grant or loan is given. Thus, Howe continues to benefit now from the past receipt of the replacement subsidies.

7.74 The United States submits that, in addition to demonstrating that a benefit was conferred, the benefit calculations are useful for determining an appropriate prospective remedy should the United States prevail in this case. Article 4.7 of the SCM Agreement provides that “[i]f the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay.” Although the subsidies in this case are non-recurring, the United States asserts that, given the substantial size of the subsidies involved, it is appropriate to allocate the amount of the subsidies over time in order to fashion an appropriate prospective remedy. This is because the subsidies continues to exist -- and therefore may be “withdrawn” -- for as long as they continue to benefit the recipient.

7.75 **Australia** submits that the United States did not ask the Panel to reach a finding on remedy beyond Article 4.7 of the SCM Agreement. Australia requests the Panel not to make a recommendation or suggestion on remedy consistent with Article 19.2 of the DSU. Were the Panel to find that some measure was inconsistent with Article 3.1(a) of the SCM Agreement, the way in which Australia chose to bring itself into compliance, if it were necessary to take any action at all, would

depend on the actual findings of the Panel. Australia's obligations would be to bring itself into consistency regarding the nature of any outstanding measures.

7.76 The point Australia has made is that the argument that the benefit of the subsidies should be allocated across time means that the complainant would have to demonstrate that the tie to exports stretches across the same time period. By arguing about allocation across time, the United States has created an inconsistency in its approach. On the one hand, it implies that there is a tie to exports over a lengthy period. On the other hand, it argued about exports over 1997-2000 under the grant contract.

D. ARTICLE 3.1(A) OF THE SCM AGREEMENT

1. **Text of Article 3.1(a)**

7.77 Article 3.1(a) of the SCM Agreement states:

3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact⁴, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I⁵;

⁴This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

⁵Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

2. **Principles of treaty interpretation**

7.78 The **United States** recalls that Article 3.2 of the DSU provides that the covered agreements shall be interpreted in accordance with "customary rules of interpretation of public international law", and that the *Vienna Convention* sets forth the customary rules of treaty interpretation.⁸⁶ Accordingly, the rights and obligations of the parties under the SCM Agreement must be interpreted in accordance with the *Vienna Convention*. Article 31 of the *Vienna Convention* provides that "a treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its object and purpose." According to Article 32, recourse to supplementary means of interpretation including preparatory work, *inter alia*, may be had "in order to confirm the meaning resulting from the application of Article 31."

⁸⁶ The United States asserts that the basic rules of treaty interpretation have been repeatedly relied on by the Appellate Body and WTO panels in interpreting the WTO Agreements, and refers to, e.g., *United States - Standards for Reformulated and Conventional Gasoline* ("*United States - Gasoline*"), WT/DS2/AB/R, 29 April 1996, p. 16 ("[Article 31] forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the GATT 1994 and the other 'covered agreements'").

3. **Interpretation of the phrase "contingent in law or in fact upon export performance"**

(a) application of the customary rules of interpretation of public international law

7.79 The **United States** notes that, in this case, the ordinary meaning of the text of Article 3.1 of the SCM Agreement prohibits the replacement subsidy package provided to Howe by the Australian government. Article 3.1(a) of the SCM Agreement prohibits “subsidies contingent in law *or in fact*, whether solely or as one of several other conditions, upon export performance.” (emphasis supplied by the United States). Thus, the prohibition in Article 3.1(a) extends not only to subsidies *expressly* based on export performance (*de jure* export subsidies), but also to subsidies that are *in fact* based upon export performance (*de facto* export subsidies). The term “subsidy” is defined in Article 1 of the SCM Agreement as a “financial contribution” by a government, such as a loan or a grant, that confers a “benefit.” The ordinary meaning of the term “benefit” is captured by its dictionary definition: a benefit is “a favourable or helpful factor or circumstance; advantage, profit.”⁸⁷

7.80 According to the United States, the dimensions and purpose of the prohibition on *de facto* export subsidies are illuminated by the drafting history of this provision. The Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the GATT (the “Tokyo Round Subsidies Agreement”) provided generally in Article 9 that “Signatories shall not grant export subsidies on products other than certain primary products”, and this prohibition included all export subsidies – both *de jure* and *de facto*. During the Uruguay Round negotiations in Negotiating Group 10 on subsidies and countervailing measures, the European Community proposed that the application of the prohibition to *de facto* export subsidies be clarified:

The prohibition of export subsidies in Article 9 of the Subsidies Code should be reformulated in order to define clearly its scope. This prohibition must apply to all export subsidies, that is, all government interventions which confer, through a charge on the public account (in the form of direct financial outlays or revenue foregone, such as tax relief and debt forgiveness), a benefit on a firm or an industry contingent upon export performance.

In addition, since experience has shown that government practices may be easily manipulated or modified in order to avoid this prohibition, it is apparent that a prohibition only of those subsidies which are de jure (that is, expressly) made contingent upon export performance is open to circumvention.

The prohibition, in the present discipline also applies to subsidies de facto contingent upon export. This, however, makes it necessary to provide for clearer guidance in identifying de facto export subsidies ... De facto export subsidies are those where facts which were known -- or should clearly have been known -- to the government when granting the subsidy demonstrate that the subsidy, without having been made expressly contingent upon export performance, was indeed intended to increase exports.⁸⁸

7.81 The United States submits that footnote 4 in the text of Article 3.1 of the SCM Agreement clarifies that the “in fact” standard “is met when the facts demonstrate that the granting of the subsidy,

⁸⁷ *The Concise Oxford Dictionary*, 8th ed., p. 102.

⁸⁸ MTN.GNG/NG10/W/31, 27 November 1989, *Elements of the Negotiating Framework -- Submission by the European Community*.

without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings.” While the note also cautions against finding a *de facto* subsidy on “the mere fact that a subsidy is accorded to enterprises which export”, this admonition is premised on finding an export subsidy based on “that reason alone”, that is, where the fact that the recipients happen to export is the *only* factor indicating that a subsidy is a *de facto* export subsidy.

7.82 In addition, the United States contends, the Uruguay Round negotiations expanded the scope of a prohibited subsidy. Rather than requiring that export performance be the “only” or the “most important” element, Article 3.1(a) provides that export performance may be *either* the sole contingency for the subsidy *or* merely “one of several other conditions”. The export requirement therefore does not need to carry preponderant weight in the approval of benefits to qualify as an export subsidy. Rather, an export subsidy will exist when actual or anticipated exportation is merely one of several potential criteria influencing the bestowal of benefits. This expansion of the definition in the SCM Agreement recognizes the serious and harmful consequences flowing from export subsidies. Thus, even in circumstances where export performance is only one of several criteria for award of the subsidy, a finding that the subsidy is a prohibited subsidy would be warranted and, indeed, compelled. Moreover, by explicitly including a footnote emphasizing that subsidies are prohibited without having been made expressly contingent upon export performance, the SCM Agreement recognizes that Members may well attempt to mask the export-orientation of particular benefits by claiming that they are bestowed without explicit contingencies. Yet, if the totality of the circumstances reveals that these benefits are designed to promote exports, then such benefits fall within the broad definition of Article 3.1(a).

7.83 **Australia** submits that the Panel is being asked to address a number of issues that have far-reaching implications for the interpretation of Article 3.1(a) of the SCM Agreement. Australia asserts that the Panel is being asked by the United States to widen the application of the “in fact” condition in Article 3.1(a) of the SCM Agreement to include the nature of any prior measure and to interpret it as a trade effects test on the basis of a subjective, case-by-case assessment of the level of exports by an enterprise. This movement away from the hard rules-based approach of Article 3 of the SCM Agreement was rejected by Australia.

7.84 Australia contends that the issue whether the subsidies are contingent “in fact” upon export performance has to be analysed in the context of footnote 4 to Article 3.1(a) of the SCM Agreement, which defines, and thereby limits the scope of, “in fact”. Australia asserts that the onus is on the United States to demonstrate that the conditions are met. *Inter alia*, the United States has to: (a) present the relevant “facts” to the Panel; and (b) prove that these facts demonstrate that the granting of the subsidy is in fact tied to actual or anticipated exportation or export earnings. This is not a question of analyzing the incidence of a subsidy as distributed between domestic and export sales. This is a matter of proving that the act of granting the subsidy is tied to export sales. According to Australia, the United States does not do that.

7.85 Australia argues that this means that the required proof is not one of economic inference but rather that the actual or anticipated exportation or export earnings are actually tied to the granting of the subsidy. The second sentence in footnote 4 means that it is not sufficient to look at a company’s exports to demonstrate the “in fact” standard. Rather, the complainant must produce facts that show the granting is actually tied to export performance. The fact that an enterprise has a high level of exports, or the fact that its exports are increasing, do not demonstrate that the standard of footnote 4 has been met. The wording of the text is to distinguish between the situation where something is set out explicitly in legislation or regulation and where there is some non-legislative, administrative arrangement whereby the granting of the subsidy is actually tied to export performance. Australia states that neither is true in this case.

7.86 Australia asserts that the rules are more rigorous for export than domestic subsidies because export subsidies allow companies to sell more cheaply on export markets while benefiting from higher domestic prices. Hence, the original bi-level price test in Article XVI:4 of GATT 1947. This was obviously too simple to prevent circumvention and the rules were elaborated leading to the Illustrative List annexed to the Tokyo Round Subsidies Agreement. Again, these were all measures that targeted, that favoured, exports. There was never any suggestion that some high level of exports test would apply.

7.87 According to Australia, the SCM Agreement maintains the Illustrative List (with some changes and interpretations in Annexes II and III) and the concept of “export performance”. For a subsidy to fall under Article 3.1(a) of the SCM Agreement, whether in law or in fact, its granting must be conditioned on “export performance”. This is not about it being an exporting firm or being export ready. It is about favouring concrete, tangible exports.

7.88 Australia maintains that the SCM Agreement is permissive of subsidies that do not fall under Article 3.1. Such subsidies are not prohibited by the SCM Agreement. For example, traditional subsidies paid on the basis of production are clearly permitted under the SCM Agreement. This is reflected in the structure of the SCM Agreement, where Part II of the SCM Agreement does not apply to such subsidies, but instead Part III of the SCM Agreement provides for multilateral remedies for such measures where adverse effect can be demonstrated. Where adverse effects are alleged to be caused by subsidies in the sense of Article 5 of the SCM Agreement, a Member has a multilateral remedy under Article 7 of the SCM Agreement. In particular, for a case of serious prejudice, Article 6.3 of the SCM Agreement sets out criteria for the establishment of a case of serious prejudice. This is the basis for pursuing allegations of adverse effect for subsidies whose granting is not explicitly tied to export performance.

7.89 According to Australia, the essential difference is between a hard rules-based test and a trade effects test. Article 3.1(a) of the SCM Agreement sets out rules for a breach of the SCM Agreement and they are to be treated as strict criteria and not an effects-based set of tests. They call for facts to be established, rather than for a Panel to look at trade outcomes. Australia submits that the United States' position turns on the argument that some undefined level of exports by an enterprise is indicative of its status under Article 3.1(a) of the SCM Agreement.

7.90 Australia argues that the United States' approach, if accepted, would lead to results at clear variance with the object and purpose of the SCM Agreement, and indeed could lead to absurdities. In the case of an enterprise that exports, what would be the outcome if a panel were to judge that a high level of exports in itself met the “in fact” test of Article 3.1(a) of the SCM Agreement? No number, no bright line has been established under the SCM Agreement. How would a Member know whether a measure was to fall under Article 3.1(a) of the SCM Agreement? Would the threshold be 50%, 75%, or 90%? Would an increase in exports by a recipient potentially make a measure inconsistent after the decision to grant? In the view of Australia, it would be inappropriate for panels to make case by case judgments on these sorts of issues when it came to questions of violation of a rule such as Article 3.1(a) of the SCM Agreement. Provisions on rules need to provide clear guidance to Members without introducing a large element of subjectivity, which would be the case if the level of exports or other such concepts were to be introduced into any assessment under Article 3.1(a) of the SCM Agreement.

7.91 Australia asserts that, depending on the circumstances, a Member that considers that it is being adversely affected in some way by such a subsidy has a number of remedies open to it, including multilateral remedies under Article 7 of the SCM Agreement and Article 26 of the DSU, or countervailing duty provisions. Thus, under the SCM Agreement itself there are already

remedies to be pursued in Parts III and V, rather than Part II. Australia notes that Article 27.4 (including footnote 55) of the SCM Agreement clearly envisages that the level of export subsidies can be quantified. This would be inconsistent with an approach that said that only a panel can determine what falls under the “in fact” provision of Article 3.1(a) of the SCM Agreement on a subjective, case-by-case basis. This would be further complicated if the performance of an enterprise could somehow change the status of a measure, which could arise under a level of exports approach.

7.92 As a further example, Australia notes that some unquantified level of exports test would cause a potential conflict with the purpose and operation of Article 13(c) of the Agreement on Agriculture (“Due Restraint”). The obligations on export subsidies under the Agreement on Agriculture are quantitative and so need to be clear cut. If the definition of “export subsidy” under the Agreement on Agriculture includes measures meeting such an “in fact” test, then it would be virtually impossible for many Members to conform with quantitative disciplines of the Agreement on Agriculture. On the other hand if the definition of “export subsidy” under the Agreement on Agriculture does not include measures meeting such an “in fact” test, then they would not be given cover by the Due Restraint article and so be subject to the disciplines of the SCM Agreement. This is clearly not what was envisaged when the agreements were negotiated.

7.93 Australia asserts that the United States seeks to reinterpret the meaning of “in law or in fact” and footnote 4 in Article 3.1(a). The concepts of “*de jure*” and “*de facto*” do not appear in the SCM Agreement, or indeed in the Tokyo Round Subsidies Agreement. The assertion by the United States that Article 9 of the Tokyo Round Subsidies Agreement “included all export subsidies -- both *de jure* and *de facto*” is simply an assertion and without any actual, concrete meaning. Article 9 of the Tokyo Round Subsidies Agreement did prohibit export subsidies, but this was not defined beyond the Illustrative List. There was no such division between *de jure* and *de facto* or any definition of what *de facto* might mean. Australia is not aware of any panel decision on this issue under the Tokyo Round Subsidies Agreement. If it had been the accepted jurisprudence that the notion extended to the much wider scope being argued here by the United States, it is surprising that it was never utilized by the United States or other signatories. In any case, the actual situation under the Tokyo Round Subsidies Agreement is irrelevant to the current case, which is under the WTO Agreement. This is not even a successor agreement.

7.94 Australia contends that the current SCM Agreement does not refer to “*de jure*” and “*de facto*” but to “in law” and “in fact” and the latter is defined and limited through footnote 4. While some broader definition might or might not have been in the mind of the European Community when it submitted MTN.GNG/NG/W/31 of 27 November 1989, the final text only emerged much later from the negotiations. Australia notes that a plain reading of the relevant section in the EC paper shows that it was concerned that the Tokyo Round Subsidies Agreement already covered subsidies “de facto contingent upon export” and that: “[t]his, however, makes it necessary to provide for clearer guidance in identifying de facto export subsidies, in order to *avoid undue extensions* of the category of export subsidies.” (emphasis supplied by Australia) Australia suggests that this could be read as the European Community seeking to limit the scope of any new agreement in this area. The third paragraph of the same section makes it clear that the European Community is looking at a situation where: “subsidies aim at distorting trade by favouring exports. A mere reference to the effect if [sic] a subsidy on exports, as observed ex post facto, would be inconsistent with this rationale. If it cannot be shown that, on the basis of the facts which the government knew – or should clearly have known – when granting the subsidy, the intention of the government was in fact to favour exports, and therefore it cannot be said that the subsidy aims, de jure or de facto, at distorting trade, this subsidy should not be prohibited; it should rather be subject to remedial action if and when it produces demonstrable negative effects on trade.”

7.95 Australia points out that, at that stage of the Uruguay Round negotiations, there were a number of proposals concerning the ambit of the provision in question. The United States, in MTN.GNG/NG10/W/29 of 22 November 1989, argued for the prohibition of: “[a]ny subsidies to a firm and/or firms [footnote omitted] predominantly engaged in export trade, i.e. whose exports exceed [X] per cent of total sales.”⁸⁹ That was not accepted. Indeed, Australia submits, the argument of the United States before the Panel appears to be an attempt to achieve what it sought unsuccessfully in the Uruguay Round.

7.96 Australia notes that, in MTN.GNG/NG10/W/29, the United States did not call such subsidies export subsidies, but rather distinguished them from export subsidies by calling them “trade-related subsidies”, but nonetheless prohibited. As with Article 3.1(b) of the SCM Agreement, such subsidies would have been prohibited but were not “export subsidies”.

7.97 Australia states that, in MTN.GNG/NG10/W/38, this concept was listed as one of the reasons for the presumption of serious prejudice (Article 6.1(c)) with a footnote to the effect that it might appear instead under the prohibition article (then Article 1) with a different threshold percentage. This was a provision additional to, and separate from, the “in law or in fact” rule on export subsidies. It was included under the deeming of serious prejudice provision (Article 6.1) in the Chair’s consultation draft for MTN.GNG/NG10/W/38/Rev.2 with a square bracketed figure of 95% but without the footnote referencing the prohibition article (Article 3). Australia, at least, was opposed to the provision and presumably many other participants shared this view, because it was dropped completely from the actual version of MTN.GNG/NG10/W/38/Rev.2, which emerged from the consultations.

7.98 Australia asserts that this goes to demonstrate that Uruguay Round participants were not prepared to accept that a high level of exports should lead to a deeming of serious prejudice let alone prohibition. In addition, the draft provisions on prohibition for a high level of exports would have been separate from the “in fact or in law”, which was already in the draft. Thus, the drafters of the text saw the high level of exports, while potentially creating a prohibited category under the agreement, as a category separate from the export subsidy (in law or in fact) category. Moreover, even the United States did not consider during the Uruguay Round that a high level of exports would satisfy an “in fact” test, since it did not characterize such situations as export subsidies but instead part of a separate category of trade-related subsidies.

7.99 According to Australia, this goes to underline that countries have always been careful not to confuse the categories for which disciplines are being negotiated, and not to overreach themselves on what it was sensible to seek disciplines from a practical point of view. The disciplines on export subsidies are in respect of subsidies that discriminate, that target, that favour, exports against domestic sales. Any other construction would lead to a potentially unworkable discipline and lead to uncertainty about its application by governments. That sort of uncertainty is what the new DSU is supposed to reduce because an automatic system without a high degree of certainty in its future application would undermine its legitimacy.

7.100 In the context of the negotiating history, Australia states, MTN.GNG/NG10/23⁹⁰ dated 7 November 1990 was circulated by the Chairperson of Negotiating Group 10 prior to the Ministerial

⁸⁹ See section I.1.b of MTN.GNG/NG10/W/29, 22 November 1989: *Elements of the Framework for Negotiations -- Submission by the United States*.

⁹⁰ Australia states that this was originally circulated as MTN.GNG/NG10/W/38/Rev.3.

meeting at Heysel in December 1990. The footnote to “in fact” (then numbered Footnote 3) read in its entirety⁹¹:

This standard is met whenever the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in *practice* tied to actual or anticipated exportation or export earnings. (emphasis supplied by Australia)

7.101 Thus, Australia states, the unagreed text that the Chairperson sent to Heysel in December 1990 had two very different aspects to that which is in the SCM Agreement, that is: (a) what the facts had to demonstrate was the standard of “in practice” rather than the much higher standard of “in fact”; and (b) the important, limiting qualifier of the second sentence had not been added. For Australia, the change in the drafting makes it clear that some participants were not prepared to accept a nebulous “in practice” standard. The current text appeared in the Draft Final Act, MTN.TNC/W/FA, of 20 December 1991, except that the change from “whenever” to “when”, came later from the Legal Drafting Group.

7.102 Australia submits that the “in fact” standard in Article 3.1(a) of the SCM Agreement is not some undefined *de facto* standard. The “in fact” standard is defined in footnote 4. In order to establish that that standard is met, footnote 4 must be satisfied. This sets a high threshold for the complainant. The construction that the United States puts on Article 3.1(a) and footnote 4 of the SCM Agreement is not borne out by the drafting. The text of Article 3.1(a) says: “subsidies contingent, ... in fact, whether solely or as one of several other conditions, upon export performance ... [footnote 4 omitted]”. In order to prove that any particular measure before the Panel satisfies this, the United States must prove that the measure is a subsidy contingent in fact, whether solely or as one of several other conditions, upon export performance, where the “in fact” standard is defined in footnote 4 of the SCM Agreement. The text is clear that “contingent in fact” is a condition that must be proven to exist.

7.103 Australia observes that the United States seeks to argue that: “the mere fact that a subsidy is accorded [*sic*] to enterprises which export” means “the fact that the recipients happen to export is the *only* factor indicating that a subsidy is a *de facto* export subsidy.”⁹² According to Australia, this misrepresents the limitation inherent in the second sentence of footnote 4 of the SCM Agreement. This sentence means that the complainant cannot just look to an enterprise’s exports as the grounds for proving the standard in the first sentence. Of course, it can be assumed that a case would only arise where there was exportation. Accordingly, the interpretation that the United States seeks to put on the limitation inherent in the second sentence of footnote 4 of the SCM Agreement would trivialize it. This additional sentence underlines that the level of exports by an enterprise cannot be the basis for proof of “in fact tied”, i.e. the extent of exportation by the enterprise is not relevant for the required demonstration. Rather, the complainant must show that the granting of the subsidy is in fact tied in its application to export performance and so favours export over domestic sales.

7.104 Australia notes that the United States argues that: “[r]ather, an export subsidy will exist when actual or anticipated exportation is merely one of several *potential criteria influencing* the bestowal of benefits.”⁹³ (emphasis supplied by Australia) Australia asserts that this is not what the text says, which is that the granting of the subsidy has to be in fact tied to actual or anticipated exportation or export earnings. This not only confuses what the United States might have wanted out of the Uruguay Round and what is in the SCM Agreement, but even seems to go well beyond it. The idea that “potential criteria” might determine whether a measure was in breach of a treaty obligation would

⁹¹ Australia noted that this formulation was first presented in MTN.GNG/NG10/W/38/Rev.2.

⁹² See *supra*, para. 7.81.

⁹³ See *supra*, para. 7.82.

make a nonsense of a binding treaty. Australia queries: Who would decide what are “potential criteria”? Presumably, either the complainant or the panel. There is no way in advance that a Member could decide what might be regarded as “potential criteria” by others when seeking to formulate its commercial policy in keeping with its treaty obligations. The recognition by a government that an enterprise exports and that internationally competitive industries are desirable does not somehow convert a subsidy that does not favour exports into a prohibited measure.

7.105 According to Australia, a logical conclusion of the United States' argument is that if a government gives an enterprise a subsidy in the knowledge that it exports, and does not expressly say that exportation is a bad thing, then the subsidy is prohibited. The government of virtually every Member provides subsidies that knowingly go to some enterprises that export and these governments are normally on the record that they consider exports a good thing, and indeed are on the record praising successful export industries. To suggest that suddenly all those measures fall within the scope of Article 3.1(a) of the SCM Agreement would be to radically upset the balance of obligations under the WTO Agreement and risk making the SCM Agreement, in particular, completely unworkable.

7.106 Australia maintains that the United States again seeks to widen the obvious meaning of the text through its argument that, by explicitly including a footnote emphasizing that subsidies are prohibited without having been made expressly contingent on export performance, the SCM Agreement recognizes that Members may well attempt to mask the export-orientation of particular benefits by claiming they are bestowed without explicit contingencies. This is not a rule about “expressly contingent” or “explicit contingencies”. The “in law” standard is about the requirement of export performance being just that, in law, e.g. in legislation. The “in fact” standard is about “in fact tied” by some means such as an administrative instrument. Indeed, in both cases, the tie must be explicit, either in law or in fact. With respect to the United States' request that the Panel make a determination on the basis of the “facts and circumstances”, Australia asserts that the findings by the Panel on each measure before it will need to be made on “the facts”, not the “circumstances”, and whether “the facts” demonstrate unequivocally that the standard in footnote 4 of the SCM Agreement is met.

7.107 Australia submits that, in accordance with the principles of treaty interpretation, the Panel needs to look at the wording in the treaty in its own context. The final text of the SCM Agreement is part of the balance of rights and obligations under the WTO. This includes the strict limitation under footnote 4 of the SCM Agreement to the scope of “in fact”. Negotiating countries did not sign on to, and would not have signed on to, the sort of open ended interpretation that the United States is now seeking to read into the text. This provision must also be read in the context of Parts III and V of the SCM Agreement, where there is provision for multilateral and unilateral remedy from adverse effects allegedly being caused by subsidies. Quite apart from this case, a widening of the scope of the meaning of “in fact” would have a potentially far-reaching impact on the balance of Members' rights and obligations under the WTO.

7.108 Australia contends that the United States' arguments in this case regarding several measures in respect of a single enterprise can tend to obscure the substantial issues being dealt with. Rules regarding prohibition must relate to the type of measure involved, rather than leaving discretion to a panel to decide on the situation. Without that clarity, it would not be possible for Members to have any surety that they are complying with their treaty obligations. This is quite different from a trade effects test where there is no breach of treaty obligation but rather a subsequent obligation to remove the non-violation nullification or impairment (including serious prejudice under the SCM Agreement), if demonstrated.

7.109 In Australia's view, if there were to be some undefined concept such as a high level of exports or the possibility that an enterprise would increase its level of exports, which would render a measure

prohibited according to a Panel ruling, then the treaty would be unworkable and Members would be able to challenge measures capriciously. Moreover, if an adverse interpretation were to rely upon there being only one enterprise in an industry, then this would be biased against smaller Members and would even potentially open the door to a future finding that the receipt by a sole domestic seller (which also exported) of any subsidy would be a prohibited measure. Australia states that this would clearly not be the object and purpose of the discipline under Article 3.1(a) of the SCM Agreement.

7.110 On the other hand, Australia asserts, consider the case where there were, say, two enterprises in an industry, one of which was domestically-oriented and one of which was export-oriented. The creation of a rule that meant that a subsidy programme was a prohibited measure when received by one company, but not when received by the other, would be a substantial move away from a sensible rules-based discipline. It would be a bias against smaller Members and would upset the balance of rights and obligations negotiated under the WTO. It would make the day-to-day provision of advice to governments on complying with their treaty obligations almost impossible to do with any certainty. At the end of the day, this would be a degeneration into the situation of a large Member being able to threaten a dispute with any smaller Member that did not fully comply with its demands, since there would no longer be a framework of objective rules against which Members could act to obtain the safe haven of compliance.

7.111 Australia submits that once the Rubicon has been crossed of using a subjective level of exports test as being the determinant for “in fact”, the logical consequences become increasingly difficult to reconcile with a sensible regime. As one example, Australia considers the situation of any non-specific subsidy programme, i.e. non-specific in the sense of Articles 2.1, 2, and 4 of the SCM Agreement. Invariably, that subsidy will be being received by some enterprise that exports much of its product and indeed may even be wholly devoted to exports of some product. Australia queries whether that would mean that that measure is, in the hands of that enterprise, a prohibited measure under Article 3.1(a) of the SCM Agreement and so specific under Article 2.3 of the SCM Agreement? Would this then mean that the entire programme suddenly becomes specific? Australia maintains that these types of consequences would make the Agreement incoherent and potentially unworkable. Australia points out that, to put this in perspective, this is not an issue such as countervail, where there is a degree of discretion placed in the hands of the investigating authorities (at least in the first instance) to take decisions on such matters as the status of a measure. This case is dealing with the issue of the conditions under which the granting or maintenance of a measure is inconsistent with treaty obligations.

7.112 Australia stresses that the concepts of “in law” and “in fact” should not be confused with *de jure* and *de facto*, especially *de facto*. The text of the SCM Agreement could always have simply said “*de jure* or *de facto*” and left those terms undefined. Indeed, the United States said that these were in the Tokyo Round Subsidies Agreement implicitly.

7.113 Australia notes that what the text actually does is to introduce a new term, “in fact”, and then it goes on to define it. While people will often use the expression “in fact” as being simply the translation of “*de facto*”, this is not the case here. Thus, the use of expressions such as *de jure* and *de facto* in this context has the potential for semantic confusion. The expression “in fact” in Article 3.1(a) of the SCM Agreement is a special term defined in the agreement through Article 3.1(a), including, in particular, footnote 4. The application of the term is restricted through that definition.

7.114 Australia maintains that a key to the interpretation of “in law or in fact” is to ensure certainty to governments, to avoid harassment and the possibility of being at some stage found to be in breach of Article 3.1(a) of the SCM Agreement. The problems here would be compounded by any views about allocation of measures across time into the future, which would be impossible to bring into

conformity *ex post facto*. Industries and governments would have great difficulty in living with that sort of uncertainty, which would undermine the legitimacy of the WTO with domestic constituents.

7.115 The **United States** argues that the inclusion of an “in fact” standard in Article 3.1(a) of the SCM Agreement inherently requires the Panel to conduct a case-by-case analysis of the relevant facts to determine whether the subsidy in question contravenes Article 3 of the SCM Agreement. However, that does not mean that the Panel must engage in an abstract or hypothetical analysis of when the standard in Article 3.1 may be satisfied. The Panel need only decide based upon the totality of facts before it whether the subsidies in question are “in fact tied to actual or anticipated exportation or export earnings.” The Panel should look to the assumptions underlying the government's decision to grant the subsidy in order to determine whether the “in fact” standard has been met. The drafters of this provision recognized that an “in fact” export subsidy would depend on the particular facts surrounding the grant of the assistance. As footnote 4 to Article 3.1(a) states, the “in fact” standard is met “when *the facts* demonstrate” that the granting of the aid is tied to actual or anticipated exportation or export earnings.

7.116 For the United States, it is clear that the Panel is expected to review all of the facts surrounding the granting of the subsidy, whatever those facts may be. The drafters of the Agreement could have listed exactly *which* facts or factors are to be considered -- as they did in other places in the Agreement. However, no such limitation was provided in this instance. The Panel must therefore take into consideration all the information relevant to making an “objective assessment of the facts of the case and the applicability of and conformity with the relevant agreement” as required under Article 11 of the DSU.

7.117 The United States declares that a case-by-case approach is entirely consistent with the requirements of Article 11 of the DSU. Indeed, in this respect, the Panel can draw on the experience of other panels and the Appellate Body in interpreting and applying Article III of GATT 1994 in cases of *de facto* discrimination. In its Report in *Japan - Taxes on Alcoholic Beverages* (“*Japan – Alcoholic Beverages*”), the Appellate Body explicitly endorsed a case-by-case approach to such disputes:

We agree with the practice under the GATT 1947 of determining whether imported and domestic products are “like” on a case-by-case basis....

... In applying the criteria cited in *Border Tax Adjustments* to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgement in determining whether in fact products are “like”. This will always involve an unavoidable element of individual, discretionary judgement.⁹⁴

7.118 The United States asserts that drawing the line between *de facto* discrimination and legitimate domestic tax measures or regulations is a task which, in a sense, mirrors the task this Panel faces -- yet past panels have showed themselves equal to the task of gathering and evaluating facts, and coming to legal conclusions on the basis of their best judgement of those facts.

7.119 The United States submits that the Panel’s inquiry concerning *de facto* export subsidies can also be analogized to past panels’ examination of the issue of whether discriminatory taxation is protective in nature. As the Appellate Body stated in *Japan – Alcoholic Beverages*:

⁹⁴ WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, pp. 20-21.

... we believe that an examination in any case of whether dissimilar taxation has been applied so as to afford protection requires a comprehensive and objective analysis of the structure and application of the measure in question on domestic as compared to imported products. We believe it is possible to examine objectively the underlying criteria used in a particular tax measure, its structure, and its overall application to ascertain whether it is applied in a way that affords protection to domestic products.

Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure. The very magnitude of the dissimilar taxation in a particular case may be evidence of such a protective application, as the Panel rightly concluded in this case. Most often, there will be other factors to be considered as well. In conducting this inquiry, panels should give full consideration to all the relevant facts and all the relevant circumstances in any given case.⁹⁵

7.120 The United States submits that the Panel should determine whether *these* subsidies are in fact “tied to” export performance by examining the totality of facts and circumstances in this case. Whether a tie exists may be objectively discerned from the history, design, architecture and the structure of the subsidies, corroborated by public statements by government officials, statements by the industry benefiting from the subsidies, the level of the recipient's exports and other relevant evidence. As stated above, footnote 4 to Article 3 directs the Panel to examine the facts by stating that the “in fact” standard is met “when *the facts* demonstrate” that the granting of the aid is tied to actual or anticipated exportation or export earnings. The United States asserts that even Australia agrees that establishing a violation of Article 3 involves a “matter of proving that the act of granting the subsidy is tied to export sales.”

7.121 The United States observes that this approach is also consistent with the European Community's suggestion during the Uruguay Round negotiations that the “in fact” standard is met where the “facts which were known - or should clearly have been known - to the government when granting the subsidy demonstrate that the subsidy, without having been made expressly contingent upon export performance, was indeed intended to increase exports.”⁹⁶

7.122 The United States asserts that Australia's view that the “in fact” standard is met only when the subsidy is *explicitly* tied to exportation or export earnings through some means such as an administrative arrangement should be rejected as it would merge the categories of subsidies “contingent in law” and subsidies “contingent in fact.” To the United States, Australia's proposed interpretation would effectively write the “in fact” language out of the SCM Agreement thereby partially defeating the purpose of the prohibition in Article 3. The distinction between the “in law” and “in fact” standard is that “in law” subsidies are explicitly contingent and “in fact” subsidies are implicitly contingent. The United States posits that these standards are not defined, as Australia suggests, by whether the contingency appears in legislation versus some type of administrative instrument.

⁹⁵ *Ibid.*, at p. 29; the United States asserts that this passage was also cited with approval in Appellate Body Report, *Canada - Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997, p. 30.

⁹⁶ MTN.GNG/NG10/W/31, 27 November 1989, *Elements of the Negotiating Framework -- Submission by the European Community*, United States Exhibit 57.

7.123 The United States also argues that Australia's position is not supported by the negotiating history of the provision. The negotiating history of this provision demonstrates that the distinction between an "in fact" and an "in law" export subsidy is that an "in fact" subsidy does not make the conferring of the benefit *expressly* contingent on export performance, in any form. The "in fact" standard was included because the countries negotiating the WTO Agreement were concerned that limiting their prohibition to subsidies with *express* export contingencies would permit governments to escape the sanctions of Article 3.1(a) by merely omitting an explicit reference to export performance from the characterization of the benefit. As the European Community warned: "experience has shown that government practices may be easily manipulated or modified in order to avoid [a de jure] prohibition...."⁹⁷ A prohibition of subsidies "which are de jure (that is, expressly) made contingent upon export performance is open to circumvention."⁹⁸ As a result of these concerns, both "in law" export subsidies -- where government aid is "expressly contingent" upon export performance -- and "in fact" export subsidies -- where the exportation requirement is not explicit -- were included as prohibited subsidies.

7.124 Furthermore, the United States asserts, imposing the requirement that prohibited export subsidies are only those that are explicitly contingent upon exports would defeat the purpose of prohibiting "in fact" export subsidies. If express statements of export contingency were required for both "in law" and "in fact" subsidies, governments could easily circumvent the prohibition in Article 3 by merely deleting explicit references to the export-contingency requirement. This was just the kind of "manipulation" that the "in fact" provision was designed to prevent. Since export subsidies are considered so egregious by the SCM Agreement that they are prohibited (rather than merely actionable), it seems unlikely that negotiators would have allowed countries to avoid their obligations by clever draftsmanship. Australia's proposed interpretation should therefore be rejected because it is at odds with the history and purpose of the provision.

7.125 The United States maintains that because Australia argues that both "in law" and "in fact" subsidies must have express statements of export contingency, it is forced to find another difference between these two forms of prohibited subsidies. Australia therefore suggests that "in law" export subsidies are those created by legislation or regulations, whereas "in fact" export subsidies are those set forth in non-legislative administrative instruments. Australia proposes that an "in fact" export subsidy may only be found if (1) the document creating the government aid is in the form of an administrative instrument, and (2) that instrument contains an express statement that the aid is export-contingent. To the United States, it is obvious that Australia has designed this test so that the instruments bestowing the subsidies upon Howe would fall outside of the definition of a prohibited export subsidy. However, Australia's attempt to distinguish "in law" and "in fact" subsidies based on *the type of document* announcing the government aid must fail.

7.126 The United States declares that Australia's theory does not have a rational basis. There is no difference *in effect* between a government provision included in a law, a regulation or a document issued by a duly authorized government official in the form of an administrative instrument or executive order. All are issued by a government entity or official with the necessary legal authority to require adherence to its terms. All have the force and effect of law and must be honoured by the nation's public entities and private citizens. The distinguishing feature of "in law" and "in fact" subsidies cannot therefore be the type of document creating the subsidy -- but whether or not the granting of the benefit is expressly or in fact tied to export performance.

7.127 Finally, the United States maintains, contrary to Australia's argument, the United States is not suggesting an expansion of the definition of prohibited export subsidies through the creation of an "unidentified level of exports" test or "trade effects" test. Australia bases this claim on its view that

⁹⁷ *Ibid.*

⁹⁸ *Ibid.*

the United States' case turns on the argument that some undefined level of exports by an enterprise is indicative of its status as a prohibited subsidy. Examining a recipient's level of exports does not transform an "in fact" export subsidy case into a "trade effects" case. The level of an enterprise's exports is just one factor to be considered in determining whether that enterprise received a prohibited export subsidy. Footnote 4 to Article 3 does not preclude consideration of the level of exports, it simply proscribes finding a prohibited export subsidy based *solely* upon the level of exports. In fact, the explicit reference to level of exports in Article 3 seems to indicate that the drafters specifically contemplated that the level of exports would be taken into account in determining whether an "in fact" subsidy exists.

7.128 According to the United States, there is a significant difference between examining whether a subsidy was tied to exportation at the time it was granted (as is necessary in an "in fact" subsidy case) and what happens after a subsidy is conferred (as is required in an actionable subsidy case). Actionable subsidy cases examine the adverse effects of a subsidy evidenced by injury to a Member's domestic industry, nullification or impairment of a Member's benefits, or serious prejudice to a Member's interests.⁹⁹ The definition of "serious prejudice" also looks to the consequences of a subsidy, such as whether subsidized goods displaced a member's goods in the subsidizing country or in a third country market, whether significant price undercutting occurred, or whether a subsidized primary product was able to increase its world market share.¹⁰⁰ Regardless of the particular standard, all of these inquiries examine the subsidy's effect *after* it has been granted. They do not address the facts as they existed at the time of the granting of the subsidy.

7.129 The United States asserts that nothing in the arguments it has presented suggests that a subsidy would necessarily be considered an "export subsidy" simply because exports increased after a subsidy was granted. In this case, the Panel must consider the facts underlying the decision to grant the aid which existed at the time the government made the decision and whether that decision was tied to actual or anticipated exportation or export earnings. The United States has not suggested that, in this case or any future case, an increase in exports after a subsidy has been provided could retroactively alter the nature of the subsidy. The United States has, therefore, not used a "trade effects" test for an "in fact" export subsidies case. Instead, the U.S. government has presented evidence of Howe's export performance at the time the decision to grant the subsidies was made, and Howe's expected export performance as anticipated at that time. This evidence meets the standard for determining an "in fact" subsidy set forth in footnote 4 to Article 3.1(a) of the SCM Agreement, which, as explained above, permits the consideration of an enterprise's level of exports.

7.130 **Australia** states that Article 3.1(a) of the SCM Agreement only prohibits subsidies that are contingent upon export performance, i.e. that favour exports over domestic sales. Australia notes that the United States has continued to quote selectively from the EC Uruguay Round negotiating paper, MTN/GNG/NG10/W/31, and to omit EC comments that underline that the issue in that paper for both *de jure* and *de facto* export subsidies was in respect of subsidies that favour exports.

7.131 Australia also asserts that the United States mischaracterizes the points made by Australia regarding "in fact" in saying that it would effectively write the "in fact" language out of the SCM Agreement. The United States appears to consider that "in law" is synonymous with "expressly". Of course, Australia states, "in law" means that it would be set out expressly in a legal instrument. However, it is quite possible for the granting of a subsidy to be expressly contingent upon export performance through administrative actions without it being expressly set out in law. Australia asserts that the Panel needs to address the meaning of "in law" and "in fact" under the SCM Agreement and not how the United States might consider that *de jure* and *de facto* should be used outside the WTO context. Under the *Vienna Convention*, the Panel needs to look at the ordinary meaning given to the

⁹⁹ SCM Agreement, Article 5.

¹⁰⁰ SCM Agreement, Article 6.3.

words “in law”. If, under the treaty, this were supposed to mean “expressly”, as the United States seemed to be proposing, then it would have said so.

7.132 In the view of Australia, the purpose of the “in fact” provision is to provide a way of dealing with the situation where the administration of a subsidy programme allows the disbursement of funds to favour exports, i.e. to provide subsidies to firms tied to export performance. Interpreting the provision in this way is not to write the “in fact” standard out of the SCM Agreement, as suggested by the United States. Instead, according to Australia, what it achieves is: (a) to make it consistent with the language of the agreement; (b) to make it consistent with the language in Article 11 of the DSU by which panel cases have to be assessed; and (c) to make it consistent with a workable and balanced view of the object and purpose of Article 3.1(a) of the SCM Agreement. To allow a violation case to be won on weak inferential grounds would be at odds with a rules-based system. An “in fact” case may often be difficult to prove. However, the SCM Agreement provides fast, effective means of relief from adverse effect on a multilateral and unilateral level through Parts III and V. In the absence of a case under Parts III or V, it is highly questionable that a weak case, missing the facts to demonstrate that the granting of the measure was in fact tied to export performance, should be able to be addressed through Part II of the SCM Agreement.

7.133 Australia suggests that it may be useful to consider just a couple of possible examples of where the “in fact” provision would apply, i.e. where the administration of a subsidy programme allows the disbursement of subsidies to favour exports. Any number of hypothetical constructions of this sort can be created, for example:

- (a) the administrators of a scheme have the authority to determine the amount of subsidy being provided to an individual firm and do so on the basis of exports rather than some other criteria such as investment or production; or
- (b) the administrators of a scheme have the authority to discriminate amongst firms in the same industry by not paying the subsidy unless concrete export targets are met.

7.134 Australia submits that the term “in law” needs to be taken as meaning just that: in law. The text of Article 3.1(a) of the SCM Agreement makes the distinction between “in law” and “in fact”. If the intent was to make the distinction between explicit and implicit, i.e. between expressly and some trade effects test, as seems to be being suggested by the United States, the text would have said so. For example, it could have read: “subsidies contingent, explicitly or implicitly, upon export performance” with a similar footnote as footnote 4 on “implicitly”. However, that is not the text. The distinction is between “in law” and “in fact” where, in both cases, there must be an actual tie with export performance.

7.135 According to Australia, WTO rules on violation are not supposed to be about subjective judgments by panels on trade effects or mind-reading what ministers may have been thinking two years ago. Article 3.1(a) and footnote 4 of the SCM Agreement are about a panel reaching the conclusion, demonstrated through an objective assessment of facts, that the granting of a subsidy is contingent upon export performance, even though it may not be required in law.

7.136 Australia submits that, in a trivial sense, every panel must undertake a case-by-case examination and analysis of the dispute before it. However, the issue here is whether the outcome is to be an arbitrary one that could well vary from panel to panel, or whether there is to be the normal consistency and certainty required of a rules-based system with respect for a Member’s sovereignty to be allowed to adopt measures that are not explicitly inconsistent with the WTO Agreement. The important principle at stake here is the necessity under a rules-based system for governments acting in good faith to be able to determine WTO consistency of proposals in advance of their implementation, and in the absence of a dispute and a panel decision. Unless a government can know in advance what

its obligations are, it would be placed in a situation that would only risk bringing the rules into disrepute. Indeed, Article 3.2 of the DSU sets out that: “[t]he dispute settlement system of the WTO is a central element in providing *security and predictability* to the multilateral trading system.” (emphasis supplied by Australia)

7.137 Australia reasserts that Article 3.1(a) of the SCM Agreement uses the phrases of “in law” and “in fact” with “in fact” limited through footnote 4 of the SCM Agreement. There is nothing in the ordinary meaning of the phrases or in the drafting history to suggest that these expressions should not be taken as meaning other than through either a legislative instrument or, alternatively, through administrative action of some sort. Indeed, the text requires a complainant to prove that “the facts demonstrate ... is in fact tied”. This is not a call for arbitrary judgement, but rather expresses the necessity for the complainant to prove its case that the granting of the subsidy is actually tied to exportation or export earnings.

7.138 According to Australia, the SCM Agreement does not list which facts are to be considered because the issue is one of demonstration of an actual tie and so what needed to be listed was what the granting of the subsidy was to be “tied to”, i.e. “actual or anticipated exportation or export earnings”. These are the points that had to be listed and listed exhaustively. The text does not talk of some high proportion of benefits going to exports or the incidence of the subsidy in relation to exports. It could have, and the United States argued in the Uruguay Round negotiations that it should, but it did not. Instead, the final text requires a factual demonstration, i.e. an objective demonstration that the granting of the subsidy be tied to exportation or export earnings.

7.139 Australia takes note of the United States' citation from the Appellate Body Report in *Japan – Alcoholic Beverages* that “the examination requires a comprehensive and objective analysis” and that “it is possible to examine objectively the underlying criteria ... to ascertain whether it is applied in a way that affords protection to domestic products.”¹⁰¹ Australia states that this is an objective assessment of the impact of the tax measure. The first sentence of the second paragraph of the United States' citation from the Appellate Body Report¹⁰² underlines that it is the actual measure and not some subjective assessment of the aim of the measure that is at issue. Moreover, Australia asserts, in that case, the Appellate Body goes on to emphasize that “[t]he dissimilar taxation must be more than *de minimis*.”¹⁰³ This is quite different from this current dispute, which is not about affording protection in excess of *de minimis* levels, but rather whether the standard of Footnote 4 of the SCM Agreement is satisfied. A government can be expected to understand the impact of different taxation arrangements on products. However, it cannot be expected to foresee what view a panel might have on the incidence of a domestic subsidy.

7.140 Australia observes that the United States goes on to say that the Panel should, among other things, focus on “the design, architecture and the structure of the subsidies”, picking up the phrase used by the Appellate Body in *Japan – Alcoholic Beverages*.¹⁰⁴ Read in context, the Appellate Body did not mean by “design” the “process of designing”, since that would go back to fathoming the aim of the government concerned. The “design, architecture and the structure of the subsidies” can only refer to the legal structure of the subsidy arrangements and their administration, rather than the issue of intent or prior measures. Australia agrees that the Panel needs to look at the contracts, what they actually say, and how they were administered.

¹⁰¹ WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 29.

¹⁰² *Ibid.* This sentence reads: “Although it is true that the aim of a measure may not be easily ascertained, nevertheless its protective application can most often be discerned from the design, the architecture, and the revealing structure of a measure.”

¹⁰³ *Ibid.*, p. 30, final paragraph.

¹⁰⁴ WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996.

7.141 Australia alleges that the United States mischaracterizes the Australian position in respect of the difference between “in law” and “in fact”. They are not the same. Australia considers that for the “in law” standard to be met it has to be just that – the contingency on export performance must be set out in law. This is clear from footnote 4 of the SCM Agreement, which refers to “legally contingent”. By contrast, “in fact” would arise through explicit administrative action rather than being set out in law. The complainant has the obligation to prove that this is being done. The way in which a complainant would demonstrate that there is such administrative action will depend on the particular case.

7.142 Australia argues that it is clear from the United States' argument that it misunderstands the point being made by Australia by interpreting the Australian position to mean that an “in fact” export subsidy may only be found if (1) the document creating the government aid is in the form of an administrative instrument, and (2) that instrument contains an express statement that the aid is export-contingent. Australia did not say that there had to be a document creating the government aid and is not sure what the United States means when it says the “document ... is in the form of an administrative instrument.” There may be a language problem here. Moreover, Australia certainly did not say that “that instrument” [whatever it might mean] “contains an express statement”

7.143 Australia contends that the distribution of any subsidy will have a legal basis and have to be administered to some degree, even if it is only to check the paper work and write out the cheques. For the “in law” standard to be met, the granting of the subsidy has to be “legally contingent” upon export performance. By contrast, the “in fact” standard is met when that distribution is still contingent upon export performance but when it is done administratively without it being legally contingent. For example, the administrative instrument might be Ministerial discretion in giving money to companies on the basis of their export earnings in the previous period. Conceptually, there are many ways in which this could be done. However, the payments must be actually tied to exportation or export earnings, either future or past, and this tie must be direct and not the result of some theoretical apportionment by the complainant between domestic and export sales because the company concerned exports.

7.144 Australia insists that it did not say that the complainant needs to find a piece of paper with an explicit tie in it, since that would be too high a threshold and defeat the purpose of preventing circumvention. However, the complainant must prove that the administration of the granting of the subsidy involved has some form of explicit tie.

7.145 With respect to the United States' argument that it proffered evidence of Howe's high level of exports to show what the Australian government considered *at the time* the aid was given, Australia argues that the United States clarifies that its legal argument relates only to what might have been considered as future export trends at the time the contracts were executed. Australia thus assumes that “*at the time* the aid was given” means the time of execution of the contracts rather than the actual time the decisions were taken to make payments after the first payment under the grant contract. The United States appears to be unconcerned here with what happens afterwards. To Australia, this appears to still mean that the United States' argument is no more than a level of exports test as the key criterion, rather than a demonstration that the granting of the subsidy is actually tied to exportation or export earnings. If actual export performance subsequent to the establishment of a programme is irrelevant, including to future payments, then there is no tie. The United States is not even arguing about the actual impact on exports let alone the legal issue of whether the granting is tied to export performance.

7.146 Australia maintains that the United States is saying that it is not making a case about what actually happens to exports subsequent to the execution of the contracts. This would mean that if the Panel considered that the issue was not the granting of the grant contract, but rather the granting of the

grants under the grant contract, then the United States would consider that its arguments would not apply.

7.147 Regarding the United States comments that there is a significant difference between examining whether a subsidy was tied to exportation at the time it was granted and what happens after a subsidy is conferred, Australia states that the issue of prohibition under Article 3.1(a) of the SCM Agreement must be strictly construed. There is multilateral remedy for adverse effect under Part III of the SCM Agreement, including adverse effect caused by exports. The SCM Agreement makes provision for remedy under both Parts III and V where exports are causing adverse effect, in particular where there is an increase in exports that causes serious prejudice. In such circumstances, especially where Article 6.1(a) of the SCM Agreement applies, increased exports would usually make a case of serious prejudice difficult to rebut. A principle of interpretation is that:

[o]ne of the corollaries of the “general rule of interpretation” in the *Vienna Convention* is that interpretation must give meaning and effect to all the terms of the treaty. An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.¹⁰⁵

Australia submits that the “in fact” test in Article 3.1(a) of the SCM Agreement is not there to deal with all cases where exports are causing injury. Rather it is there to deal with the situation of “in law or in fact” as Australia has described it. Members have Part III of the SCM Agreement to seek multilateral remedy in other cases.

(b) operational considerations

7.148 **Australia** adds that, apart from the issue of maintaining the balance of rights and obligations about what was negotiated in the Uruguay Round, a key issue here is to ensure that the interpretation of the disciplines under Article 3.1(a) is workable. This is not a situation where WTO rules are being implemented through domestic legislation, such as for countervailing. In that case, domestic law-makers and the courts will converge to a practical arrangement, which is in conformity with WTO obligations. The obligations of officials are domestic: to implement the domestic law subject to judicial review. The situation is quite different where officials have to give advice to their government, and ministers have to make decisions on that advice, about conformity of proposed new programmes with WTO rules. Of course, countervailing duty legislation has to go through this once, i.e. when changes are put in place, but not on a day-to-day basis when being implemented domestically. However, with industry policies in goods, services and intellectual property, officials have to give advice every day on the WTO-consistency of new policy proposals.

7.149 Australia underlines that it is critical that officials be able to give advice on clear-cut rules. Australia can accept that, in early stages, there may be some differences in view over rules, without being absolutely certain that that envelope for manoeuvre will be maintained after a dispute. But that is quite different from a situation where some form of *de facto* test would make it virtually impossible to give clear advice.

7.150 Australia states that it is a long-standing integral part of the GATT, and now the WTO, that there is always a small risk of a non-violation case. Australia states that government officials give advice on this where required, for example on subsidies in respect of bindings. However, that does not involve a treaty commitment. Ministers have to know whether an action would breach a treaty.

¹⁰⁵ Appellate Body Report, *United States – Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 23.

They can accept that there might be complaints of the non-violation type, but that is absolutely different from a case of violation of a treaty commitment. If this dispute led to an outcome where a Member's government can never be certain about whether it is consistent with its WTO obligations, except by not having a policy at all, that will serve to bring the system into disrepute. Governments will not accept an edict that subsidies or some other policy instrument are going to be somehow banned by the back door. Indeed, one potential outcome is that governments will take less care rather than more.

7.151 Australia asserts that the structure of the SCM Agreement was to give greater certainty to governments in the provision of subsidies. The aim of defining a subsidy was to give greater certainty about what sort of measures might be subject to multilateral action and to countervailing duty action. The aim of the "red/amber/green" distinction was also to give safe harbour for green subsidies and to provide a more effective remedy for adverse effects case. In reality, there was little change to the categories of prohibited subsidies. Subsidies falling under Article 3.1(b) of the SCM Agreement were already covered (apart from GATT exceptions) by Article III of GATT (or indeed also under the WTO by paragraph 1 of the Annex to the Agreement on Trade-Related Investment Measures). Any interpretation that pushed back the boundaries of Article 3.1(a) of the SCM Agreement would lead to governments and industry being once again placed in the situation of great uncertainty about future action under the WTO.

7.152 Australia states that governments and industry can accept rules that apply to all Members provided that they know the ground rules, and provided that the status of proposed measures is clear. Members would all have difficulties dealing with a situation where no one would know until there was a WTO challenge. The situation would become absurd if, in addition, the success or otherwise of a challenge depended on economic developments or newspaper articles. The problems would be further compounded if the rules were seen to be different for small and large Members in their application. It would be a retrograde step for the WTO if Members with large domestic markets and numerous firms were implicitly subject to different rules than smaller Members with smaller domestic markets, and possibly single sellers, but a reliance on other markets for growth due to economic factors such as returns to scale.

7.153 Australia underlines that the Panel needs to bear in mind that whatever comes out of this Panel must result in an operational and workable system for governments acting in good faith if the WTO subsidies regime is not to be brought into disrepute. A government knows well when it provides greater protection for individual products such as in the GATT 1994 Article III:2 case cited by the United States. However, by contrast, it could not know in advance what view a panel would take if the grounds put forward by the United States were to be adopted by the Panel and the Appellate Body.

7.154 Similarly, Australia continues, if a government was paying money on the basis of export performance through administrative action, it would know that that was the case and it would know that it was in breach of its WTO obligations. The situation would be clear to the government concerned. However, by contrast, the United States' position is that even if a government knows that its decisions have absolutely nothing to do with exports, it might still be found to be in breach of its WTO obligations. A government would be faced with the situation where if a company, or some of the companies in an industry, are export-oriented or even just export, a panel might find that its WTO obligations had been inadvertently breached. That is not a viable situation, and underlines that the United States' approach to treaty interpretation would lead to absurd results.

7.155 Australia states that, in a rules-based system, officials must be able to give clear advice to governments whether proposals are consistent or inconsistent with WTO obligations, i.e. whether treaty obligations would be breached. This cannot be done on the basis that, for example, some firms

in an industry depend on exports for their viability. In any small country many industries export and, regardless of the proportion of their product that they export, depend on other markets for achieving profitability and some economies of scale. The United States' position is that potentially a subsidy to a firm that does not export at all, and has no intention of exporting, can be a prohibited export subsidy under Article 3.1(a) of the SCM Agreement. This sort of scenario underlines that the United States' logic can lead to any number of absurd situations.

7.156 Australia reiterates that a rules-based system must provide clear guidance to governments about the nature of their WTO obligations. Governments can accept that where market developments lead to allegations of adverse effects by other Members, then there may be non-violation cases brought, including cases under Part III of the SCM Agreement, or alternatively exports can be subject to countervailing duty action. There is nothing new about that. What governments would find hard to accept is a situation where they would have no guidance and where they would breach treaty obligations quite inadvertently without prior warning.

7.157 Australia submits that the United States' position on the "in fact" standard would provide no guidance to Members about what might constitute a prohibited subsidy. It would provide *carte blanche* for trying to close markets through Part II of the SCM Agreement. Where a Member is suffering adverse effects it has other remedies, including countervailing action, which is subject to detailed rules. Indeed, virtually any case where subsidized imports are such as to cause material injury in an importing Member's market would provide sufficient evidence to be an "in fact" export subsidy in the eyes of the United States. This would serve to make much of Part III of the SCM Agreement redundant, inconsistent with the normal rules of treaty interpretation.

7.158 In addition, Australia continues, the way in which the United States has pursued the issue of the ICS and EFS gives rise to concerns about due process. These schemes do not apply to automotive leather. The view of the United States that the nature of a prior scheme affects the legal nature of a subsequent scheme has no basis. It would make the task of governments ensuring compliance with their international obligations all that much more difficult and conceptually could result in the absurd situation where two Members could have exactly the same scheme but their legal nature would be different because of differences in their prior arrangements. This just highlights the unreasonable basis of the position of the United States. For the Panel to reach some conclusion about the legal status of a measure that no longer exists and has never been subject to a dispute panel under the GATT system or the WTO, would be inconsistent with the central principle that Members' measures are presumed to be in conformity unless successfully challenged under the appropriate dispute settlement procedures.

7.159 The **United States** responds that it is the nature of legal rules that they are drafted in general terms and cannot be expected to provide bright-line tests for specifically resolving all hypothetical scenarios. That is why there are rules of treaty interpretation to help resolve interpretative issues and dispute settlement panels to apply general legal rules to particular factual situations. The drafters of the SCM Agreement chose to include an "in fact" standard, which by its nature requires a fact-based, case-by-case approach in its application. If the "in fact" provision of Article 3.1(a) is to fulfill the purpose for which it was intended -- to prevent circumvention in fact of the prohibition in law against export subsidies -- a case-by-case approach is necessary. If the drafters had regarded a case-by-case approach as undermining the stability of the WTO system, they obviously would not have included an "in fact" standard in the prohibition.

7.160 The United States maintains that some uncertainty is inevitable in a case-by-case approach. This uncertainty is diminished to a certain extent as the application of this provision is clarified by panel decisions. In conducting a case-by-case analysis, a panel must use its best judgment in objectively assessing the facts of the case. Likewise, in attempting to conform its conduct to the

requirements of the SCM Agreement, a Member must use its best judgment in deciding whether a subsidy would fall within the prohibition in Article 3. Furthermore, exactly the same line of argument could be made concerning determinations of *de facto* discrimination under Article III of GATT 1994. Yet, the Appellate Body has recognized that such an approach does not undermine the stability and predictability of the WTO system, particularly in light of the benefit of this approach, namely preventing the circumvention of the prohibition at issue.

4. **Application of Article 3.1(a) of the SCM Agreement in this dispute**

(a) "contingent, in law ... upon export performance"

7.161 The **United States** submits that, because Howe was granted the new aid package as a specific replacement for the *de jure* subsidies of the ICS and EFS export schemes from which it was excluded pursuant to the November 1996 settlement, the new subsidies are also *de jure* export subsidies. In its first written submission to the Panel, the United States said that it had been unable to document fully that the new subsidies are legally contingent upon Howe's export performance because, despite previous requests, the Australian government had refused to provide the United States with copies of Howe's proposal to the Australian government (and other documents relating thereto) which generated the additional aid or the resulting agreement between the Australian government and Howe setting forth the terms of the benefits and the criteria for their receipt.¹⁰⁶

7.162 The United States believes that the replacement subsidy package accorded to Howe by the Australian government is a prohibited export subsidy within the meaning of Article 3 of the SCM Agreement; for this reason it requested that the Panel ask Australia to produce certain documents which would demonstrate, *inter alia*, whether the package is *de jure* or *de facto* an export subsidy.

7.163 **Australia** submits that the United States has put forward no evidence that any of the measures is contingent "in law" upon export performance. Indeed, in Australia's view, the issue of "in law" is not before the Panel, since in WT/DS126/1, while "in law or in fact" is part of a quote in the second paragraph, the terms of reference depend on the third paragraph which only discusses the "in fact" case. Australia observes that the United States does raise the issue of "in law" (or rather it refers to "*de jure*" by which it presumably means "in law") in its first written submission to the Panel. However, it presents no evidence and its argument appears to be the same as for its "in fact" case, i.e. that the measures were put in place following the excision of automotive leather from the ICS and EFS. This does not demonstrate the "in law" condition. Indeed, Australia asserts, it demonstrates that is not germane even to the demonstration of the "in fact" condition. Similarly, the United States chose not to avail itself of the proper procedures under the SCM Agreement (Article 25.8) to seek information and so it can hardly argue on the basis of the lack of information.

(b) "contingent ... in fact ... upon export performance"

(i) *General*

7.164 The **United States** asserts that, even if the grant and loan contracts presented by Australia do not demonstrate that the replacement package is a *de jure* export subsidy, the Panel should find that the prohibition on export subsidies applies in situations like the one presented here: where a subsidy exists; and where that subsidy is *de facto* contingent on export performance. The Panel should determine that the grants and loan provided to Howe by the Australian government constitute *de facto* export subsidies on the basis of the totality of the facts and circumstances in this case.

¹⁰⁶ These documents were provided to the Panel and the United States at the first substantive meeting of the Panel with the parties, subject to procedures adopted by the Panel governing the handling of business confidential information.

7.165 According to the United States, the new financial aid package was specifically designed to compensate Howe for the export subsidies it forfeited under the settlement agreement with the United States. In addition, the Australian government intended that the new package would support Howe's current and future exports. When it provided these subsidies, the Australian government was fully aware that Howe was first and foremost an exporter and that the Australian market for automotive leather goods was minimal in comparison to the existing and potential export market for these goods. The Australian government was aware that, by 1997, exports constituted 90 per cent of Howe's sales. There can be no doubt that Howe's increased production will be destined for exportation, since Australia's small automotive leather market cannot absorb Howe's current production, much less any increase in sales or production. Finally, the structure of the aid package itself reveals that the new subsidies are in fact tied to Howe's anticipated export earnings. In light of the totality of the circumstances surrounding the provision by the government of Australia of these replacement subsidies to Howe, the United States considers that Australia has unquestionably bestowed a prohibited export subsidy upon Howe.

7.166 **Australia** submits that there is a clear distinction between "law" and "fact" in ordinary language. The terms "in law" and "in fact" are clearly used to distinguish between the ways in which the granting of a subsidy is made contingent upon export performance. "In law" means just that, "legally contingent" as used in Footnote 4 of the SCM Agreement. "In fact" is where the implementation is such as to tie the granting of the subsidy to actual or anticipated exportation or earnings. In particular, this occurs where a scheme is administered in such a way as to favour exports without being legally contingent on export performance. The loan contract and the grant contract prove that in neither case was there any legal contingency. In addition, there was no legal contingency for the payments under the grant contract. The contracts also show that there was no way in which they could be administered to tie the granting of subsidies to actual or anticipated exportation or earnings. There is no way in which they could be administered to favour exports over domestic sales.

7.167 According to Australia, the loan and grant contracts are separate legal instruments. The loan contract and other measures need to be considered separately on their merits in respect of consistency with Article 3.1(a) of the SCM Agreement. Australia asserts that it has shown that the granting of the loan contract clearly had no linkage to export performance, and that this is evident from the loan contract itself. Australia states that it has shown that the loan contract does not meet the "in fact" standard of Article 3.1(a) of the SCM Agreement.

7.168 Australia observes that there is a difference of views over the terms of reference of the Panel in respect to the grant contract. If the Panel accepts that it is the conditions of the granting of the individual payments that is at issue, then the United States has not even sought to show that the "in fact" standard was met. In addition, only the granting of the first payment and the granting of the second payment are before the Panel. Assuming, in the alternative, that the Panel concludes that the issue before it is the granting of the grant contract, then the granting of the grant contract clearly has no linkage to export performance. Australia maintains that it has shown this and that this is, in any case, evident from the grant contract itself. The functioning of the grant contract is shown by the way in which the actual payments were made where the record¹⁰⁷ shows that there was no tie to export performance. Australia states that it has shown that the grant contract does not meet the "in fact" standard under Article 3.1(a) of the SCM Agreement.

7.169 Australia asserts that the issue of the nature of the ICS and the EFS as they applied to automotive leather is not before the Panel and should not be addressed by the Panel. In Australia's view, under the WTO Agreement, there is a presumption that measures taken by Members are in

¹⁰⁷ Australia refers in this regard to business confidential information it provided to the Panel. Also see *infra*, para. 7.298.

conformity unless successfully challenged under the appropriate dispute settlement procedures of the DSU and the appropriate covered agreements.

(ii) *Prior measures and the designing of alternative assistance to Howe*

7.170 The **United States** argues that the A\$30 million grant and the A\$25 million preferential loan were provided to Howe solely because automotive leather was removed from the ICS and EFS export schemes. Since these industry programmes were clearly export subsidies and since the new financial aid was expressly designed to replace these benefits, the new assistance qualifies as a prohibited export subsidy.

7.171 In the view of the United States, there can be little doubt that the ICS and EFS export schemes are *de jure* export subsidies. The explicit purpose of both the ICS and the EFS programmes is export promotion. In order to achieve this goal, subsidies available under these programmes were made legally contingent upon export performance. The greater the value of a company's exports, the greater the value of subsidies it was eligible to receive. Between 1992 and 1997, Howe received at least A\$29 million under the ICS programme and more than A\$5 million under the EFS programme. By making subsidies under these programmes legally contingent upon exportation, both the ICS and EFS programmes clearly fell within the Article 3.1(a) of the SCM Agreement, which prohibits "subsidies contingent, in law . . . upon export performance."

7.172 The United States described the ICS and EFS as follows¹⁰⁸:

"Enacted in 1988, the Textiles, Clothing and Footwear Development Authority Act established the Australian Textiles, Clothing and Footwear Development Authority, the stated object of which is "to promote the restructuring and revitalization of the [textile, clothing and footwear] industries so as to improve their efficiency and international competitiveness."¹⁰⁹ To this end, the functions of the Authority are, *inter alia*, to "encourage and facilitate the development of plans aimed at increasing the international competitiveness of [Australian textile, clothing and footwear] producers by providing financial assistance to them for that purpose" and to develop "measures calculated to . . . increase the exports of TCF products produced in Australia . . ."¹¹⁰

Pursuant to this mandate, in 1991, the Australian government announced the creation of the [ICS] program, to be in effect from July 1, 1991, through June 30, 2000.¹¹¹ Under the [ICS] program, exporters of eligible textile, clothing and footwear products can earn import credits that may be used to reduce the import duties payable on eligible textile, clothing and footwear items by an amount up to the value of the credits held.¹¹² However, exporters are not required to use their credits as offsets against import duties. These credits may be

¹⁰⁸ Note that notes 109 - 123 are as they appeared in the United States submission.

¹⁰⁹ TCF Development Authority Act 1998, Part II, §6(a), Exhibit 6.

¹¹⁰ *Id.* at Part II, § 7.

¹¹¹ Australian Customs Service, TCF Import Credit Scheme: Administrative Arrangements (March 1995), paras. 1.1 and 1.2. Exhibit 7. The TCF Import Credit Scheme is administered by the Australian Customs Service on behalf of the TCF Development Authority. *Id.* at para. 1.1.

¹¹² *Id.*

transferred from one holder to another in exchange for a cash payment.¹¹³

Under the ICS program, the level of import credits that may be earned is explicitly conditioned upon export performance. Specifically, the value of import credits that can be earned is calculated as the F.O.B. value of an eligible export sale, multiplied by the Australian value-added content of the export sale (expressed as a percentage of sales volume).¹¹⁴ This total, in turn, is multiplied by a specified "Export Phasing Rate."¹¹⁵ Between 1991 and 1997, the Export Phasing Rate stood at .30 (*ie*, 30% of the F.O.B. value of the Australian value-added content of eligible textile, clothing and footwear exports). The Export Phasing Rate was recently reduced to .20.¹¹⁶ Expressed as a formula:

Import credit = Export sale (FOB A\$) x Australian value-added expressed as a percentage of sales volume x Export phasing rate¹¹⁷ ...

The Australian government designed the EFS program to encourage the export of passenger motor vehicles ("PMV") and PMV components from Australia.¹¹⁸ In its current form since 1991,¹¹⁹ the EFS program allows Australian manufacturers to earn A\$1 of export credit for every dollar of eligible exports of covered automotive items.¹²⁰ The value of exports eligible to earn exports credits is equal to the Australian value-added content of eligible exports, calculated as the F.O.B. sales price less the value of any imported components and raw materials.¹²¹

Export credits earned under this program can be used to obtain rebates on the duties payable on eligible imports of automotive vehicles and automotive components,¹²² or may be sold for cash to any importer of

¹¹³ *Id.* at para. 8.3.

¹¹⁴ *Id.* at para. 5.1. The Textiles, Clothing & Footwear Development Authority has established value added rates across a range of categories and sub-categories for textile, clothing and footwear products, set out in Table 3 of the TCF Import Credit Scheme: Administrative Arrangements (March 1995). *Id.*, para. 5.4.

¹¹⁵ *Id.* at para. 5.1.

¹¹⁶ *Id.* at para. 6.9. Under the TCF, the Export Phasing Rate stood at 30% of the Australian value added of eligible textile, clothing and footwear exports from July 1, 1991 through June 30, 1996. It was subsequently phased down to 25%, and is scheduled to decrease to 20% on July 1, 1998 and 15% on July 1, 1999.

¹¹⁷ *Id.* at 7 (Part 5.1).

¹¹⁸ See Statement of Minister of Industry, Science & Technology John Moore, "Government Announcement on Automotive Industry Policy to the Year 2000," p. 40 (March 1991) (remarking that the Australian Government's new policies are designed to make "the Export Facilitation Scheme more flexible and rewarding to those firms prepared to make the investments needed to considerably expand their exports."), Exhibit 12.

¹¹⁹ See *Id.* (discussing how the EFS program replaced and built upon previous assistance programs provided by the GOA to the Australian automotive sector).

¹²⁰ Australian Dept. Of Industry, Science & Technology, Report on the State of the Automotive Industry 1994, (June 1995), para. C:1.3.2, Exhibit 13.

¹²¹ *Id.* at para. C:1.3. As expressed in C:1.3.6: F.O.B. selling price less imported components equals F.O.B. Australian content. F.O.B. Australian content less raw materials equals value-added.

¹²² *Id.* at para. C:3.1.1 and C:3.2.

eligible goods who may similarly seek such rebates.¹²³ The amount of import duty that can be rebated under this program is determined by a tariff reduction schedule that varies depending on the year in which the export credit is used. From a high of 37.5% of the tariff rate for export credits used in 1991, the schedule slowly scales back the amount of rebatable duty to 15% in the year 2000, the last scheduled year of the program.¹²⁴ For instance, in 1996 a company could receive a rebate equal to 25% of the export credit earned. Thus, if an exporter received A\$1,000,000 of export credits, he or his transferee could obtain a rebate of \$250,000 for import duties paid during that year."

7.173 The United States maintains that even Australia's Industry Commission recognized that the programmes are inconsistent with the Australia's WTO obligations:

The Commission finds the [automotive] export facilitation scheme has been valuable to the industry. It has served its main purpose of introducing Australian products to world markets and will expire in 2000. The Commission will not recommend its continuation because its strategic value has been undermined by its vulnerability to challenge under the rules of the World Trade Organization.¹²⁵

7.174 The United States observes that a similar assessment was made about the ICS programme:

Recent actions by the US have highlighted the vulnerability of the [ICS] Scheme to challenge under the World Trade Organization (WTO) rules...¹²⁶

7.175 The United States notes that one senior Australian government official even went so far as to state that "[t]here is no doubt the [ICS and EFS] schemes are illegal under the WTO."¹²⁷

7.176 The United States recalls that, on 25 November 1996, the United States reached an agreement with the Australian government that removed automotive leather from eligibility under these two programmes. After the settlement, the Australian government could no longer provide Howe subsidies through the ICS and EFS programmes. However, the Australian government clearly wanted to continue to underwrite Howe's export drive. As a result, at the same time that it was negotiating the November 1996 settlement with the United States, the Australian government was also considering replacement measures for the very subsidies it was pledging to eliminate.

¹²³ *Id.* at para. C:2.1.4.

¹²⁴ *Id.* at para.C:3.1.2 and C:3.1.3

¹²⁵ Industry Commission, Rep. No. 58, The Automotive Industry: The Report 351, May 26, 1997, United States Exhibit 39.

¹²⁶ Industry Commission, Rep. No. 59, The Textile, Clothing and Footwear Industries: Report 293, September 9, 1997, United States Exhibit 40.

¹²⁷ "Government may have to dismantle help schemes," The Australian Financial Review, October 3, 1996, United States Exhibit 4. According to the United States, the Australian media also recognized the "prohibited" nature of these programmes' subsidies. For instance, The Australian Financial Review ("US threat to car, ICS industries") noted on June 20, 1996 that "it had been known for some time that the export facilitation arrangements which operate under the TCF and car plans would not survive a WTO challenge." United States Exhibit 42. This same article also quoted a former senior official in Australia's Department of Foreign Affairs and Trade as stating, in regard to a possible U.S. challenge, that "[i]n simple terms, they [the ICS and EFS programs] are in trouble." The United States also refers to "A firm hand on reform," The Australian Financial Review, October 3, 1996 (editorial) ("All indications are that the schemes are indeed illegal and will be declared so in the WTO"), United States Exhibit 43.

7.177 The United States argues that, anticipating its exclusion from the ICS and EFS programmes, Howe embarked on an extensive lobbying campaign to persuade the Australian government that its export prospects -- which it forecast to be A\$600 million through 2000 -- were jeopardized without a substitute form of assistance. The United States cites a report in The Weekend Australian:

Coincidentally, the company's lobbying effort climaxed on the day Air Force One with Clinton and his entourage on board touched down in Sydney.

On the same day, [Howe's Managing Director] Heysen and a colleague flew to Canberra for a round of meetings with senior ministers and bureaucrats, beginning with officials of the Department of Industry, Science and Tourism.

A meeting followed with staff from the offices of [DIST Minister John] Moore and the Prime Minister attended by then DIST secretary Greg Taylor.

Then, to ensure all bases were covered, the opposition rooms were visited. Heysen met Simon Crean and Martin Ferguson, Industry and employment spokesmen respectively, and later in the day had an audience with [Deputy Prime Minister] Fischer.¹²⁸

7.178 According to the United States, these lobbying efforts were amply rewarded. Even before the final agreement was reached with the United States, Howe's Managing Director, Chris Heysen, remarked that he had been "assured" that Howe "would be compensated with an alternative arrangement that would help it continue to expand exports."¹²⁹ Similarly, the Sydney Morning Herald reported that "it is understood that Howe Leather will be given a multi-million dollar payment for being excluded from the Import Credit Scheme [ICS] and the Export Facilitation Scheme [EFS]."¹³⁰

7.179 In the view of the United States, that is precisely what happened. Just one month after agreeing with the United States to excise automotive leather from the ICS and EFS programmes, the Australian government formally announced that "[t]he Government has provided the package to Howe and Co. following the decision to excise automotive leather from the Import Credit and Export Facilitation Schemes from 1 April 1997, as part of the settlement of a recent trade dispute involving the United States."¹³¹ Thus, with planned coincidence, the new aid package -- characterized by the Australian government as "alternative assistance" -- was provided to Howe just as automotive leather was being excised from two programmes that had the explicit purpose of export promotion.

7.180 The United States asserts that, against this backdrop, the link between the replacement package and Howe's export performance is quite obvious. The fact that the replacement package compensated Howe for its exclusion from receipt of ICS and EFS subsidies, as well as the sequence of events surrounding the announcement of the replacement package, indicate that the replacement package is no more than a thinly disguised attempt by the Australian government to continue to support Howe's export growth by modifying only the form, but not the substance, of its export subsidies.

¹²⁸ "Sacred Cows vs The Hide of Howe," The Weekend Australian, Sept. 20-21, 1997, at 54, col. 6, United States Exhibit 22.

¹²⁹ "Melbourne firm could lose in US subsidies deal," The Age, November 25, 1996, at 1, United States Exhibit 15.

¹³⁰ "Backdown on Howe Subsidy," The Sydney Morning Herald, November 25, 1996, United States Exhibit 17.

¹³¹ United States Exhibit 18.

7.181 **Australia** submits that the nature of prior measures is irrelevant to the establishment of the facts about the legal status of existing measures. These measures no longer apply to automotive leather and so are not relevant to the current Panel proceedings. The United States appears to be seeking to establish that the legal status of a previous measure determines in some way the legal status of a subsequent measure.¹³² There is no basis for this in a rules-based regime such as the WTO. The status of each of the measures before the Panel needs to be judged on its merits. The United States is proposing a trade outcome or trade effects test. This may be appropriate in some cases of non-violation, but it is not appropriate under Part II of the SCM Agreement, where the issue is whether one or more of the measures before the Panel fall under Article 3.1(a) of the SCM Agreement. If the United States wanted to pursue the issue on the basis of trade effects, then it should have sought remedy under Part III of the SCM Agreement, i.e., under Article 7 rather than Article 4.

7.182 Australia argues that to accept that the legal status or nature of a previous measure in some way determines the status of an existing measure under the WTO, would be to inject a level of uncertainty and subjectivity into the WTO that would be quite inappropriate for a rules-based treaty. This would mean, amongst other things, that if there were two cases, one where an enterprise had been in receipt of, say, a subsidy and another enterprise had not been, a new measure could be prohibited when given to the first enterprise but not when given to the other. This would make a farce of a rules-based system. Article 3.1(a) of the SCM Agreement deals with a situation of law or fact where the type of the measure must determine its status.

7.183 According to Australia, the company concerned does not receive benefits under these programmes (ICS and EFS), since automotive leather was removed from their scope on 1 April 1997, and the United States recognizes this. The claim of the United States is limited to the measures before the Panel. The United States has not made a claim in respect of these programmes and that matter is not before this Panel. Rather, the United States has made an assertion about their status. It did not even provide any argumentation in WT/DS126/1 for that assertion.

7.184 Australia states that the United States has made a claim that the measures provided to Howe are inconsistent with Article 3.1(a) and so Article 3.2 of the SCM Agreement. This is not an issue of a trade effects test, but a matter regarding WTO rules. The United States has to establish that the conditions of footnote 4 of Article 3.1(a) are met. This is not a matter of whether or not when one measure is replaced by another there should be a markedly different production or trade outcome.

7.185 For the sake of argument, Australia asks the Panel to assume that a Member has a measure that has been found by a Panel to be inconsistent with the WTO Agreement. Its obligations are to remove the inconsistency. It does not have any obligation to ensure a particular trade outcome to satisfy the complainant. That is a political problem for the complainant, not the respondent. In the case of a subsidy, nothing in the WTO Agreement asserts that a subsidy inconsistent with Article 3.1(a) of the SCM Agreement cannot be replaced by a subsidy consistent with the SCM Agreement, or that any new subsidy or other measure must have a particular trade impact. This is in contrast to non-violation cases, including cases under Article 7 of the SCM Agreement, where the impact of an aggregation of measures may need to be dealt with.

¹³² In the course of the Panel proceedings, the United States acknowledged that a prohibited export subsidy could be replaced by another form of assistance that is not tied to export performance and a Member could thus bring itself into conformity with the SCM Agreement. However, it maintains that Australia has not done so in this case.

7.186 Australia declares that Article 3.1(a) and footnote 4 of the SCM Agreement do not talk about replacement measures, but require that the United States establish certain facts. These must be facts in relation to the actual measures before the Panel and not the relationship to programmes which are no longer in effect for the product and company in question.

7.187 In the alternative, Australia continues, if the Panel decides to look at the trade impact of previous measures, it would still be unnecessary and outside of the Panel's terms of reference for it to make any finding on what the status of ICS and EFS were under the SCM Agreement when they applied to automotive leather. These programmes do not apply to the product and company in question and so are not before the Panel. It would be inappropriate and an abuse of process to allow the Panel proceedings to be used to reach findings on programmes that are not before the Panel as measures and on which no claims are being made. For the Panel to reach any views on the nature of these programmes as they apply to any products other than automotive leather would also be outside its terms of reference.

7.188 According to Australia, any argument based on previous measures and their trade effect for a particular company when compared to that of an existing measure has no place in the WTO rules environment. The idea that somehow a government would have to disrupt a firm's commercial linkages in order to ensure WTO compliance has no basis under the WTO Agreement and is not consistent with the WTO's focus on rules. Indeed, it might even be inconsistent with Article XI of GATT 1994 or the prohibition on grey area measures under Article 11 of the Agreement on Safeguards.

7.189 Nevertheless, since the United States has put forward, as exhibits, information provided under confidential, inter-governmental consultations, Australia states that it is worthwhile setting the record straight about the process leading to the current arrangements. The United States government was never in any doubt, and accepted, that there would be new assistance arrangements for Howe following the excision of automotive leather from ICS and EFS. Indeed, there were a large number of bilateral discussions on this issue between the Australian and United States Governments both before and after the public announcement of the proposed arrangements in late December 1996.

7.190 Indeed, Australia states, it was at the repeated request of the United States that Howe was obliged by the Australian government to devote such a major proportion of payments under the grant contract to investment, with the United States even objecting to having research and development counted against payments under the grant contract. One side effect of this was the new production premises at Thomastown and Rosedale. It was the United States that demanded this investment be made where it could well have asked for the money to be paid as a simple bounty on production.

7.191 At the same time, Australia continues, the United States wanted assurances that serious prejudice would not be caused by the new arrangements. According to Australia, the United States said that it would judge the new arrangements on that basis. To comply with this, Australia sought to ensure that the impact on the United States was minimized through limiting the level of per unit subsidy on sales. Australia understood that the United States government wanted Australia to ensure that the 5 per cent level in Article 6.1(a) of the SCM Agreement was not exceeded. The issue was how to meet the twin objectives of putting the money into investment, which basically meant paying the money at an early stage (unlike a traditional bounty, which could have been paid after production), and of keeping the level of subsidy below 5 per cent. The approach adopted was to cap the aggregate of payments under the grant contract at A\$30 million to limit the overall level of *ad valorem* subsidization of sales over the period to mid-2000 while imposing investment targets,

and of course the normal due diligence considerations associated with checking on the continued viability of the company before payments were made.

7.192 According to Australia, the intent was to meet the twin requests from the United States. This was the actual basis of the nature of the grant contract (and loan). The payments were not tied to exports. Indeed the first payment was simply made following the signing of the grant contract. Subsequent payments were related to best endeavours by the company on investment levels and sales. According to Australia, the United States recognizes this. This emphasis by the United States on the link to investment, while correct, underlines that the payments were not linked to export performance. If even investment subsidies were to be taken as measures falling under Article 3.1(a) of the SCM Agreement, then it is difficult to see what limitations would exist to such an open ended interpretation of “in fact” in Article 3.1(a) of the SCM Agreement.

7.193 The ultimate dispute with the United States, as Australia understands it, is in reality about the size of the subsidies, about the aggregation of the subsidization provided. In retrospect, it turned out that the discussions between Australian and United States officials had not resulted in a meeting of minds on this issue of size. On the other hand, the United States never came forward with any claims of serious prejudice to the United States industry, which Australia had undertaken to address if it arose. Moreover, the level of aggregate subsidization is irrelevant for the purposes of Article 3.1(a) of the SCM Agreement. If the United States had a problem with that, it could have taken the matter up under, for example, Part III of the SCM Agreement.

7.194 Australia submits that the “facts” adduced by the United States in the form of newspaper articles and Ministerial statements have to be taken in their political context. In any event, it would be difficult to accept that such articles, sometimes involving stories without attribution, should be considered to provide acceptable evidence. The company involved is competitive and innovative. It is not surprising in a small trading nation that comments on successful companies include references to export markets. That, however, does not mean that there was an attempt to circumvent Australia’s WTO obligations and the United States has not produced any facts to show this.

7.195 Australia contends that the United States has tried to make much of some comment in the press. This hardly passes as proof. Indeed, the use by the United States of newspaper stories to demonstrate facts is questionable in the extreme. Newspaper comment in Australia cannot be taken as an accurate record of, or even to reflect, the views of government. It would be highly inappropriate for a Panel to take newspaper comment as the basis for determining that a Member was in breach of its treaty commitments.

7.196 In this regard, Australia comments on one United States exhibit by way of example. This purports to be a Media Release by the Minister for Industry, Science and Tourism on 27 December 1996, together with an attachment. The first page is a copy of a Media Release, which was provided to the United States in its Exhibit 2. According to Australia, this exhibit shows that the government was concerned about jobs, not about exports. The second page of this exhibit, which is portrayed as being part of the Media Release, was not that at all. It was a set of confidential talking points for discussions between the Australian Embassy and the United States government (USTR). What they demonstrate is no more than that the loan contract and grant contract were designed with the objectives of the United States government in mind and in consultation (though not ultimately agreement) with the United States, and not in isolation by Australia.

7.197 In Australia's view, when the United States seeks to argue that the company was in some way obliged to export to obtain the maximum amount of money it is unclear what it is suggesting. The SCM Agreement does not prohibit bounty, i.e. payments per unit of production by enterprises, or subsidies on investment by enterprises. Any enterprise receiving bounty or subsidies linked to

investment would get more for more production or investment. What the United States is noting is that in this case there is a cap, a maximum of A\$30 million, on what the company could receive in total regardless of how much it sold. There is no basis for arguing that to limit subsidization in this way should suddenly make a measure prohibited. The United States has not argued that the allocation of the limited quantum of money available in any way favours exports. Thus, there is no basis for this argument by the United States that any of the payments (or the grant contract) falls under Article 3.1(a) of the SCM Agreement.

7.198 The **United States** repeats that the grant and loan contracts at issue in this case were specifically and explicitly designed to compensate Howe for the prohibited export subsidies that it would have received under the ICS and EFS. The fact that the ICS and EFS programmes were *export* subsidies is highly relevant in determining the nature of the grant and loan contracts. Despite Australia's demand that each measure be judged on its own merits, the replacement subsidies that Howe received were not provided in a vacuum. The Australian government itself linked the ICS and EFS programmes with the grant/loan package by proudly announcing that "[t]he Government has provided the [grant and loan] package to Howe and Co. following the decision to excise automotive leather from the Import Credit and Export Facilitation Schemes."¹³³ Since footnote 4 to Article 3.1(a) directs the Panel to examine all "facts demonstrat[ing] that the granting of a subsidy ... is in fact tied to actual or anticipated exportation or export earnings," the Panel is obligated to consider these facts.¹³⁴

7.199 Accordingly, the United States urges the Panel to consider the nature of the ICS and EFS programmes in determining whether the replacement subsidies constitute "in fact" export subsidies. The United States is not seeking a remedy with regard to these programmes (i.e., is not asking that the Panel request Australia to bring them into compliance with its obligations under the SCM Agreement). However, as the United States considers that the new subsidies are expressly linked to the old programmes, the nature of the prior programmes provides useful and important information in evaluating the nature of the subsequent measures.

7.200 The United States argues that, beginning in 1991, and continuing through April 1997, the Australian government gave Howe a series of overt, *de jure* export subsidies through the ICS and EFS. The United States avers that it has demonstrated that the explicit purpose of both the ICS and EFS programmes is export promotion. Under these programmes, Howe received import credits based on the domestic value-added content of its exports. Receipt of these import credits was directly contingent upon export performance. The more Howe exported, the more benefits it received and so the ICS and EFS programmes are plainly inconsistent with Article 3 of the SCM Agreement. According to the United States, when the new package is considered in this context, the link between it and Howe's export performance is obvious. The fact that the replacement package was specifically designed to compensate Howe for its exclusion from receipt of ICS and EFS export subsidies indicates that the replacement package is no more than a thinly disguised attempt by the Australian government to continue to promote exportation by Howe by modifying only the form, but not the substance, of its export subsidies.

7.201 The United States declares that Australia does not dispute and, indeed, cannot dispute that the ICS and EFS programmes are prohibited export subsidies. Rather, Australia contends that the Panel may not consider the nature of these programmes in determining whether the alternative assistance provided to Howe were export subsidies. However, the United States is not asking the Panel to find that Australia must withdraw the ICS and EFS programmes because they are prohibited export subsidies. Rather, the United States is simply asking that the Panel consider the nature of these prior

¹³³ United States Exhibit 18.

¹³⁴ The United States also referred to certain business confidential information in making this argument.

measures in determining whether the replacement subsidies are in fact tied to export performance. The fact that the new subsidies were explicitly designed to compensate Howe for its exclusion from these two programmes means that the prior measures were factors in Australia's decision to grant Howe the new subsidies. This renders the nature of those measures highly relevant to the Panel's determination in this case regarding the nature of the current measures.

7.202 The United States submits, in the alternative, that even if the Panel were to decide not to consider the nature of the ICS and EFS programmes, the other evidence presented by the United States -- which Australia did not in any way refute -- leads to the inevitable conclusion that the grant and the preferential loan were tied to actual as well as anticipated exports and export earnings within the meaning of footnote 4 to Article 3.1(a). That evidence includes, among other supporting facts: the Australian government's statements at time of the new subsidies; the Australian government's knowledge at the time it conferred these benefits that Howe's exports constituted 90 per cent of its sales and the company had aggressive export plans; the grant and loan required Howe to increase its production even though the Australian leather market is too small to absorb any increased sales; and the benefits were provided only to Howe, which exports virtually all of its production, and not to any leather manufacturer that supplies the domestic market.

7.203 With respect to Australia's suggestion that the United States has somehow waived its claim that the new subsidies are prohibited export subsidies because it was consulted during the period that Australia was designing the replacement package, the United States asserts that, although it was consulted, it never agreed that a new subsidy package would necessarily comply with the requirements of Article 3 of the SCM Agreement. Australia, in fact, acknowledges this. The fact that the United States was consulted cannot change the nature of the replacement subsidies.

7.204 The United States adds that the consultations during the time that the replacement measures were being designed were in the context of settlement negotiations which ultimately proved unsuccessful. There was no agreement or endorsement by the United States with regard to the various settlement proposals.

7.205 In any event, the United States continues, statements or offers made during the course of settlement discussion in this case are of no legal consequence to this proceedings. Article 4.6 of the DSU provides that: "Consultations shall be confidential, and without prejudice to the rights of Members in any further proceedings." The question of whether statements made during settlement negotiations are relevant was address in the panel report in *United States – Underwear*.¹³⁵ In that dispute, Costa Rica improperly used information on settlement offers made by the United States to advance certain arguments to the panel. That panel found:

In our view, the wording of Article 4.6 of the DSU makes it clear that *offers made in the context of consultations* are, in case a mutually agreed solution is not reached, of no legal consequence to the later stages of dispute settlement, as far as the rights of the parties to the dispute are concerned. Consequently, we will not base our findings on such information.¹³⁶ (emphasis supplied by the United States)

7.206 The United States insists that Article 4.6 of the DSU calls for panels to disregard offers of settlement, and not to treat such offers as a waiver or admission. Accordingly, this Panel should disregard all references by Australia to any purported statements made by the United States in the context of efforts to settle this case.

¹³⁵ WT/DS24/R, adopted 25 February 1997.

¹³⁶ *Ibid.*, para. 7.27.

7.207 Australia emphasizes that the proposition by the United States that somehow the status or nature of a prior measure can determine the WTO status of a new measure, (or in this case measures) has no basis in the WTO and is without legal argument from the United States. GATT contracting parties, and now WTO Members, bring themselves into conformity with new rules, or after having lost disputes, by imposing new, consistent measures. There is nothing to suggest that losing a dispute means that suddenly a Member has less rights than before in maintaining a WTO-consistent regime. The idea of a penal regime where a Member was on parole in some sense after losing a case has no legal basis. It would be up to the United States to make a case. The United States has lost a number of disputes in the WTO, and in none of them has it said that that means it has to remove all measures bearing any relationship to the inconsistent ones. Nor has it said that its replacement measures were potentially inconsistent because they were measures aimed at replacing those found to be inconsistent. There is nothing in the WTO Agreement that suggests that existing measures can only be replaced with no policy at all. Australia makes the following additional points by way of rebuttal:

- (a) EFS and ICS do not apply to automotive leather.
- (b) Automotive leather was excised from EFS and ICS from 1 April 1997, before the request for consultations for this Panel.
- (c) The nature and WTO status of EFS and ICS for automotive leather prior to 1 April 1997 are beyond the Panel's terms of reference.
- (d) The nature and WTO status of EFS and ICS for products other than automotive leather are beyond the Panel's terms of reference.
- (e) No GATT or WTO panel has found against EFS or ICS.
- (f) Indeed, no GATT contracting party, no signatory to the Tokyo Round Subsidies Agreement, and no WTO Member has taken Australia to a Panel on EFS and ICS.
- (g) In the absence of a panel report finding against these schemes, it would be highly inappropriate for this Panel to go outside its terms of reference to examine measures that are not before the Panel and indeed do not even apply to automotive leather. If the United States wants a ruling on the WTO status of the two schemes, then it is always open to it to take such a Panel. It is not for this Panel to do the United States work outside the Panel's terms of reference.

7.208 Australia observes that arguments about the EFS and ICS form the major part of the United States' case, and that it is the United States' allegations over these schemes that represent the United States' evidence that the new assistance also qualifies as a prohibited export subsidy. According to Australia, the concentration on the EFS and ICS, in circumstances where the United States has not sought to have its allegations about these schemes addressed by a panel under the DSU, is one more example of the United States seeking to override proper procedures in this Panel process. For the United States to be allowed to conduct these fishing expeditions would be another diminution of the legitimacy of the nature of WTO dispute settlement where panels have been tightly constrained in what they look at and on what they make findings.

7.209 Australia recalls that Article 11 of the DSU requires that the "panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case...." The Panel needs to limit itself to the facts in relation to subsidies provided to producers and exporters of automotive leather that are covered in its terms of reference. These do not include EFS and ICS. Australia fails to understand the logic behind the United States' assertions. Members are permitted to change their industry settings with the obligation being that the new measures comply with their

obligations. There is nothing in the WTO that suggests that existing measures can only be replaced with no policy at all. Australia avers that clearly, the new arrangements were part of the outcome from the bilateral settlement between Australia and the United States that also led to the excision of automotive leather from the EFS and ICS. Australia acknowledges that it is unlikely that the grant contract and the loan contract would have been provided in a circumstance other than the removal of automotive leather from the EFS and ICS. However, it is too simplistic to argue that that was the sole reason for providing them. In particular, they were provided because of the government's concern about regional job retention in the absence of any support for the company in the shorter term. To Australia, the argument by the United States that "since the EFS and ICS were clearly export subsidies and since the new financial aid was expressly designed to replace these benefits, the new assistance qualifies as a prohibited export subsidy" is a simple fallacy along the lines of: if a man has A and replaces it with B, then B is A.

7.210 In response to the assertion by the United States that the "benefits were provided only to Howe"¹³⁷, Australia states that since only one firm was involved, the arrangements were necessarily for only one firm. This is to state the obvious. It does not, however, have any significance in relation to the legal status of the measures involved.

7.211 Australia points out that the argument of the United States would make it very difficult for a Member to ever bring itself into conformity without simply removing all subsidization. For example, if a Member provided export subsidies in law and it wished to bring itself into conformity, under normal logic it could simply remove the provision that favoured exports over domestic sales and not discriminate. The United States would, in those circumstances, seem to start from the position that the new scheme was prohibited because of the nature of the previous arrangements. On the other hand, had that new arrangement been introduced in a case where there had been no subsidization, it would be consistent. This severance between the nature of a measure and its status is inconsistent with the rules-based regime of the WTO governing violation of treaty commitments.

7.212 Relying on business confidential information, the United States argues that there was clearly a link -- which had been recognized by the Australian government -- between the elimination of automotive leather from eligibility under the ICS and EFS and the granting of new assistance to Howe.

7.213 Furthermore, **Australia** argues, the disciplines on export subsidies are in respect of certain types of measures. This is not a matter of how much money is provided by way of subsidy. Where a measure is replaced by another, all that matters is whether the new measure is consistent. Whether the level of subsidy is lower or higher is irrelevant.

7.214 Australia submits that, while the United States said that it was not proposing a trade effects test, it is proposing that the Panel in reality base its findings on the following: (a) the nature and status of prior measures; and (b) the level of exports of Howe of automotive leather.

7.215 According to Australia, the United States exhibits purporting to show what was in Australian Ministers' minds at the time the new assistance arrangements were designed do not demonstrate that what they had in mind was an export subsidy. Indeed, to the contrary, if the covert scenario originally implied by the United States had any semblance of truth in it, and if Ministers thought that there was any linkage with exports in the way suggested, it would not be credible that they would make any statements about exports at all. Australia provided business confidential information to the Panel concerning 1997-1998 audited sales data which, it asserts, underlines the lack of probative value of evidence submitted by the United States regarding, for example, Howe's high export levels.

¹³⁷ See *supra*, para.7.202.

7.216 In Australia's view, it is not credible that the United States and Australia would have been discussing a settlement that the United States considered to have been WTO-inconsistent. Discussions between the United States and Australia always envisaged that it was possible to provide WTO-consistent subsidies to Howe, but it was recognized that there was a risk of adverse effect, in particular, serious prejudice. The United States has not denied this. But its arguments about prior measures and the high level of exports of automotive leather by Howe were just as true then as now. Australia is not saying that the United States has given Australia a "waiver" in regard to the new assistance arrangements. Australia would agree that in the circumstances, the United States should not have brought this case, but Australia is not arguing here that the United States is estopped from doing so. However, the fact that the United States was involved in discussions with Australia over the details of the assistance package, until at least July 1997, demonstrates that the United States basic problem was about either the size of the loan and grants or some other aspect of the specific arrangements. Australia believes it is the former. If this is the case, then instead of taking and doing the work for a serious prejudice case, the United States is seeking to push out the boundaries of the SCM Agreement to obtain an export level test under Part II of the SCM Agreement. At the same time, the United States also appears to be attempting to push out the boundary of the DSU to obtain a prior measure test, which would have general application.

7.217 Australia asserts that, in respect of the specific arrangements, nothing could be more anodyne than the loan, with the United States making no substantial argument on its status. Similarly, once the trade effects test is taken away, the allegations about the grant contract and the payments under it also collapse.

7.218 Australia observes that the United States argues that although the United States was indeed consulted about the new subsidies, the United States never agreed that a new package would necessarily comply with the requirements of the Article 3 of the SCM Agreement. As the United States recognizes, Australia never said that the United States accepted any particular assistance arrangements. However, the United States clearly accepted that some arrangements would be acceptable, i.e. including being WTO consistent. Otherwise, it would have been being duplicitous during discussions where it sought and obtained in particular the devotion of much of the money provided under the grant contract to investment. Now, of course, the United States seeks to draw adverse inferences from the allocation of money to investment.

7.219 The **United States** responds that throughout Australia's submission and in response to written questions of the Panel, Australia states that the United States "understood and accepted" that an alternative assistance arrangement would be provided to producers of automotive leather. Although the United States notes that statements or offers made during the course of settlement discussions in a case are of no legal consequence to the proceeding¹³⁸ the United States asserts that it is necessary to correct this misstatement. According to the United States, it never "accepted" that alternative assistance would be provided to Howe. Australia never sought permission or acceptance from the United States to provide this assistance. Rather, Australia simply informed the United States that further assistance would be supplied. Although the United States was consulted in order to avoid further dispute settlement proceedings; as Australia acknowledges, the United States asserts that it never "agreed to or endorsed the assistance arrangement eventually implemented."

7.220 **Australia** states that the bilateral discussions between Australia and the United States, of course, did not reach the point of the United States signing off on the WTO status of the new assistance arrangements. Australia was prepared to engage in a lengthy consultative process to try and reach a mutually satisfactory solution to this issue. However, Australia contends, it should be noted that the pace of this case, and the long delays involved in it, were determined by the United

¹³⁸ The United States refers in this regard to Article 4.6 of the DSU and to Panel Report, *United States – Underwear*, WT/DS24/R, adopted 25 February 1997, para. 7.27.

States and throughout this period commercial uncertainty has hung over Howe. Nevertheless, the lengthy process of bilateral consultations also underlines the commitment of the Australian government to implement WTO-consistent arrangements. It demonstrates that the intent of the government was not to implement an export subsidy arrangement but, quite the contrary, to implement measures that would be not only completely WTO-consistent but also not cause adverse effects to the United States, while recognizing that the United States could always bring a case of serious prejudice to Australia and then, if necessary, to the WTO.

7.221 Australia recalls that there were a large number of bilateral discussions between the Australian and United States government both before and after the public announcement of the new assistance arrangements in late December 1996. These consultations included exchanges between officials from the Australian Embassy in Washington and USTR officials as well as direct contact between policy officers in Canberra involved in the development of the new assistance arrangements and officials in USTR.

7.222 According to Australia, in discussions prior to the 27 December 1996 announcement of the new assistance arrangements, USTR officials were advised of the broad framework proposed for the alternative assistance arrangements, including the fact that the arrangements would contain a one-off up-front grant payment. Australia asserts that the United States was concerned over the size of the alternative arrangements (originally A\$80 million was proposed) and the likely impact the arrangements would have on the United States industry. This reflected the nature of the bilateral settlement. USTR officials made it clear immediately following the bilateral settlement between Ambassador Barshefsky and Mr. Fischer that they would judge the WTO-consistency or otherwise of the new scheme on whether it caused problems or serious prejudice to the United States industry. In response to the concerns expressed by the United States over the level of the arrangements, the amount originally proposed was reduced markedly and the loan element introduced.

7.223 Australia observes that, in the pre-announcement discussions on the alternative assistance arrangements, the United States also expressed particular concern over the proposed "up-front" payment and suggested that the arrangements may be more acceptable if the size of this up-front payment could be reduced and that the remainder could be paid conditionally (based mainly on investment activity) over the next couple of years or paid as a production warrant over the period 1 April 1997 to 31 December 2000. It was this broad payment structure that emerged in relation to the grant contract.

7.224 Australia notes that, after the 27 December 1996 announcement of the assistance arrangements, the bulk of the discussion between Australia and the United States was about how to adjust the arrangements to address the concerns of US industry. As a result of these discussions, a number of changes were made to the details of the arrangements. The adjustments were made continually until the grant and loan contracts were signed on 9 March 1997. Moreover, further discussions, at both Ministerial and senior officials levels, continued between Australia and the United States concerning the provisions on investment and other details of the assistance arrangements of concern to the United States until July 1997.

7.225 Australia underlines that the consultations on the new assistance arrangements were extensive. They were, of course, without prejudice to either Australia's or the United States' WTO rights, but they do reflect that at least throughout this period the United States accepted that alternative assistance arrangements, consistent with Article 3.1(a) of the SCM Agreement, could be provided to Howe. Australia acknowledges that, despite these efforts, no final agreement could be reached with the United States government which met the concerns of the United States companies that initiated this complaint. Australia has not claimed that the United States ever agreed to or endorsed the assistance arrangements eventually implemented.

7.226 According to Australia, the panel report cited by the United States, *United States - Underwear*¹³⁹, is not applicable to this case. The *United States - Underwear* case was in the context of consultations under the DSU leading to the establishment of that particular panel and the allegedly compromising offer by the respondent. This case is the opposite, where Australia, in good faith, discussed with the United States what the new arrangements might be and how Australia might modify them to meet concerns of the United States.

7.227 Australia asserts that the record shows that the two governments were involved in discussions about the new support arrangements, where the prime issue was the extent of support. In Australia's mind there is and was no question about the acceptance by the United States that subsidies would be provided. There was no agreement on the new arrangements, but the discussions that took place on how the subsidies should be delivered, in particular the United States requests that the bulk of the money under the grant contract be on capital expenditure, had only one reasonable interpretation, i.e. that the United States accepted that subsidies were to be provided in one form or another.

7.228 Australia contends that the issue between the two countries was one of serious prejudice. If there had been any suggestion that the United States considered that there might potentially be a breach of Article 3.1(a) of the SCM Agreement, or indeed any other provision of the WTO, then the Australian government would have addressed it. Instead, there was the opposite scenario of the United States only raising the "in fact" provision of Article 3.1(a) of the SCM Agreement six months after binding legal domestic arrangements had been entered into by the Australian government and after the loan had been provided and the first two tranches of the grant contract paid out.

7.229 In Australia's view, the record shows that Australia was concerned to ensure WTO-consistency and, in particular, to ensure that there was no linkage with exports. Any government that was intent on doing something underhanded would have handled the issue quite differently. The reported comments on exports would, to the extent that they are accurate, simply demonstrate that the Australian government did not have anything in mind about linkages with export performance. This is also borne out by the nature of the grant contract and the basis on which actual payments were made under it. Clearly, there was no tie to export performance.

(iii) *Intent*

7.230 The **United States** submits that the Australian government intended the replacement package to support Howe's current and future exports.

7.231 The United States contends that the fact that the replacement package is meant to compensate Howe for its exclusion from the ICS and EFS export programmes is strong evidence that the true purpose of the replacement package -- like the subsidy programmes that preceded it -- is export promotion. Any doubts as to this fact are resolved by the numerous statements by Australian government and Howe officials that confirm that the replacement package is in fact tied to Howe's actual or anticipated exportation or export earnings. For instance, Australian Trade Minister Tim Fischer made it clear that the purpose of the replacement package is continued export promotion, in stating:

by dint of effort we [the Australian government] have ensured that Howe Leather has been able to continue its export activity over the last 18 months.¹⁴⁰

¹³⁹ WT/DS24/R, adopted 25 February 1997.

¹⁴⁰ "Fischer vows to fight US trade challenge," The Australian, September 29, 1997, United States Exhibit 45.

7.232 Similarly, Australia's Minister for Industry, Science and Tourism, John Moore, announced during negotiation of the replacement package that:

We are working constructively with Howe Leather to ensure that they receive fair compensation. I am determined that this strongly performing export company should not be unfairly disadvantaged by the agreement reached at Manila.¹⁴¹

7.233 According to the United States, the Australian government was aware that, at the time the new subsidies were granted in 1997, exports constituted 90 per cent of Howe's sales. The fact that exports play the overwhelmingly dominant role in Howe's overall sales mix is not coincidental. As part of a nearly decade-long effort, the Australian government has financed Howe's transformation into a world-class exporter of automotive leather. As the Australian government has itself admitted, since at least 1991, Howe has received in excess of A\$30 million worth of subsidies through two export-contingent subsidy programmes: the ICS and EFS. Because these subsidies were so lucrative, Howe was able to dramatically increase its exports. From less than 10 per cent of its total sales in 1988, exports increased to 90 per cent of Howe's total sales for the nine months through March 1997.¹⁴²

7.234 The United States alleges that, because the value of prior subsidies was legally tied to the value of Howe's exports, the Australian government necessarily had detailed information concerning Howe's export sales and their exponential increase throughout the 1990s. Beyond simply being aware of Howe's general level of exports, however, the Australian government was also aware that of the relative importance of exports in Howe's overall sales mix. For instance, even before the replacement package was announced, opposition employment spokesman Martin Ferguson is reported to have boasted that "[t]he company was a shining light with 90 per cent of Howe's production being for exports"¹⁴³

7.235 In addition to being aware of Howe's past and current export performance, the Australian government was also aware of Howe's aggressive export plans. In Howe's November 1996 proposal to the Australian government seeking new subsidies, Howe reportedly predicted that its annual sales would roughly double -- to \$214 million -- by 2000, "with the lion's share of the growth coming from exports."¹⁴⁴ In fact, not only was the Australian government aware of Howe's export ambitions, but it actually designed the replacement package to further facilitate and encourage Howe's ambitious export goals.

7.236 According to the United States, the fact that the replacement package is being provided to promote Howe's exports was also recognized, and welcomed, by Howe itself. During negotiation of the replacement package in late 1996, Howe's Managing Director, Chris Heysen, stated that he had been "assured" that Howe "would be compensated with an alternative arrangement that would help it

¹⁴¹ Statement of Minister for Industry, Science & Tourism John Moore, "Resolution Removes Uncertainty for Industry," Nov. 25, 1996, United States Exhibit 16.

¹⁴² "Major Headache for the Howard Government," A\$ Adding Value, July 5, 1996 ("Howe's exports have risen from less than ten percent of sales in 1988, to nearly ninety percent of sales."), United States Exhibit 5; "Howe Leather Wins Wheels Award," World Leather, February/March 1997 ("The company has increased its exports from 7% to 90% of sales over the last eight years"), United States Exhibit 4.

¹⁴³ "Trade Showdown," Herald Sun, November 20, 1996, United States Exhibit 30.

¹⁴⁴ "Sacred Cows vs The Hide of Howe," The Weekend Australian, September 20-21, 1997, United States Exhibit 22.

continue to expand exports."¹⁴⁵ Similarly, in a 1997 interview with World Leather Magazine, Mr. Heysen noted that “[w]e have been strongly supported by the Australian Government and we are very confident now that our investment and export growth can continue as planned.”¹⁴⁶

7.237 And, the United States alleges, Howe has begun to achieve its export goals. In June 1998, Howe secured new orders totalling \$300 million from major U.S. automobile companies.¹⁴⁷ There is no question that Howe’s ability to secure these orders was directly attributable to the replacement subsidy package. The chairman of Howe’s ultimate parent company, Schaffer Corp. Ltd., proudly declared that its new \$300 million contracts “have been aided by the Commonwealth Government’s support package to Howe in which over \$30 million has been expended on the establishment of two world class operations for the manufacture of leather” at Rosedale and Thomastown.¹⁴⁸ Present at the opening of Howe’s new state-of-the-art processing plant in Thomastown, the Australian Minister for Industry, Science & Tourism John Moore attributed Howe’s success in “cracking” the U.S. car market to the government’s “industry policy,” which is based on innovation, investment and exports.¹⁴⁹

7.238 The United States argues that, significantly, the replacement subsidies were not offered to other Australian tanners who supply leather for domestic consumption. The subsidies were therefore not meant simply to stimulate the production of leather for sale to Australian customers. Nor were they provided to other tanners who were eligible for export credits under the ICS and EFS export subsidy schemes since they had no need of further export aid. Rather, the financial package was only made available to the sole leather tanner who was denied access to the government’s export schemes and whose exports account for virtually all of its production.

7.239 **Australia** asserts that the United States’ arguments are of the nature of trying to establish intent by way of press comment.¹⁵⁰ In this connection, panels are not supposed to be mind readers about what governments, or individual ministers, might or might not have had in mind at the time of making decisions. As any official will know, the factors that influence decision-makers are many faceted. They usually relate to things such as jobs and employment, as in this case. Of course, such decisions may often have implications for imports and exports. There is nothing surprising about that from an economics point of view. However, to arrive at a conclusion, as does the United States, that this should mean that a measure is inconsistent with a treaty obligation is a large leap into the dark.

7.240 According to Australia, an assessment of the imputed objectives of governments is not the basis on which a rules-based system such as the WTO is supposed to operate. Rules about violation are not supposed to be based on guesses at the objectives of governments. They need to be based on facts and soundly based arguments. In Australia’s view, neither of these is present in the case presented by the United States.

7.241 The **United States** insists that, in addition to the fact that the new subsidies were explicitly designed to replace the forfeited *de jure* export subsidies, there is strong evidence that the Australian

¹⁴⁵ “Melbourne firm could lose in US subsidy deal,” The Age, November 25, 1996, at 1, United States Exhibit 15.

¹⁴⁶ “Howe Leather wins wheels award,” World Leather, February/March 1997, United States Exhibit 4.

¹⁴⁷ J. Schaffer, Chairman & Managing Director, Schaffer Corp. Ltd., “Howe Leather Announces \$300M in New US Contracts,” June 18, 1998, United States Exhibit 47.

¹⁴⁸ *Ibid.* See also “Australia: Melbourne Firm in Push to Lift Exports by 15%” Australian Business Intelligence Daily Commercial News (Abstracts), June 15, 1998 (new government-funded high-technology tanning facility in Rosedale was “part of [Howe’s] efforts to lift its exports above A\$100 million a year”), United States Exhibit 48.

¹⁴⁹ Media Release, Statement of John Moore, Minister of Industry, Science & Tourism, “Australian Company Cracks US Car market With \$300M Deal,” June 18, 1998, United States Exhibit 49.

¹⁵⁰ See also Australia’s arguments in this regard *supra* paras. 7.35, 7.194 and 7.195. With respect to the assertions of the United States, *supra*, para.7.238, see also Australia’s arguments *supra*, para.7.210.

government intended the replacement subsidies to support Howe's current and future exports. There are numerous statements by both Howe and the Australian government which confirm that the replacement package is, in fact, tied to Howe's actual or anticipated exportation or export earnings.

7.242 Furthermore, the United States argues, when providing the new assistance package to Howe, the government of Australia knew that the vast majority of Howe's operations were export-oriented and that additional subsidies would serve to increase Howe's exports. This is clear from Howe's long-standing participation in the ICS and EFS programmes, the information that Howe was obligated to provide to the government in order to obtain benefits under those programmes and information Australia relied upon in crafting the terms of the assistance package. Australian government officials have acknowledged that Howe's business is essentially an exporting business, and the Australian media has acclaimed Howe as an Australian exporting success story. Thus, according to the United States, there can be no doubt that the Australian government knew at the time it agreed to the assistance package that benefits conferred would finance the continuation of Howe's exports. The fact that the replacement package was provided to promote Howe's exports was also recognized and welcomed by Howe itself.

7.243 Australia argues that the facts of the situation are straightforward. In its view, automotive leather was removed from two entitlement programmes at the request of the United States. However, for the Australian government, politically and socially, there was a requirement to provide some new arrangements for Howe. Australia questions whether anyone would seriously think that Australia would intentionally engage in a dispute with the United States in order just to export more automotive leather. Australia notes that it had hoped that, with the new arrangements, the matter would have been resolved. Australia asserts that it is the legal structure and administration of the subsidy arrangements that should be assessed, rather than the issue of intent or the nature of any prior measures. Australia submits that the Panel should look at the contracts, to evaluate what they actually say and how they are administered. Referring to business confidential information it provided to the Panel, Australia argues that the payments under the grant contract were not based on Howe's export performance.

(iv) *Conditions of the assistance and the size of the domestic market*

Factors including level of exports

7.244 The **United States** submits that the conditions of the replacement package and the limited size of the domestic market demonstrate that it is in fact tied to Howe's export earnings. According to the United States, to ensure that Howe would use these funds to increase its exports, the Australian government conditioned the grant on Howe dramatically increasing its sales, which, given the size of the domestic market, in turn meant dramatically increasing its exports. Howe had no choice but to continue to expand its exports in order to obtain the full benefits offered. The Australian government also conditioned receipt of the grant money upon Howe undertaking A\$22.8 million in approved capital investment before the year 2000. In fact, according to the United States, Howe's ultimate parent, Schaffer Corp., Ltd. has admitted that the conditions of the subsidy were tied to future exports. In its half yearly report, Schaffer stated that the A\$30 million grant was "based on projected exports and paid on performance criteria ..." and stated that the loan was given "to assist with the capital programme."

7.245 The United States observes that the terms of the grant provide that Howe will receive grant monies equal to 5 per cent of its estimated sales from April 1997 through December 2000, with a cap of A\$30 million. Thus, in order for Howe to receive the full A\$30 million grant for which it is eligible, it must generate A\$600 million in sales over the life of the replacement programme. This means that Howe must dramatically increase its annual sales. In 1996/97, Howe's sales totaled

approximately A\$114.4 million.¹⁵¹ Accordingly, Howe must increase its annual sales by an average of A\$45.6 million a year qualify for the entire A\$30 million grant.¹⁵² Given that Howe tanned approximately 10,000 hides per week during the 1996/97 fiscal year, it would need to tan approximately 4,000 additional hides per week for it to achieve such a sales goal.¹⁵³

7.246 According to the United States, the Australian government also conditioned receipt of the grant upon Howe undertaking A\$22.8 million in approved capital investment before the year 2000. Howe fulfilled this requirement by constructing a new state-of-the-art finishing plant and a new processing facility.¹⁵⁴ Howe now has a production capacity of approximately 22,000 hides per week; almost double its 1996 capacity of 11,500 hides per week.¹⁵⁵

7.247 However, the United States maintains, the Australian leather market is now -- and will remain in the future -- too small to absorb Howe's increased production. At the time the replacement package was provided in 1997, the total weekly demand for automotive leather in Australia was approximately 1,400 hides per week.¹⁵⁶ This figure is unlikely to grow significantly in the near future. The Federation of Automotive Products Manufacturers projects that annual automobile production in Australia will increase by 15 per cent between 1997 and 2000.¹⁵⁷ Assuming a corresponding (15 per cent) increase in the demand for automotive leather, by 2000 the Australian market for automotive leather will require approximately 1,600 hides per week.¹⁵⁸ Needless to say, the United States asserts, the 200 additional hides that the Australian automotive leather market will demand by 2000 is far less than the 4,000 additional hides per week that Howe must sell in order for it to earn the full A\$30 million grant, or the 22,000 hides per week that Howe is now capable of producing. The United States believes that the information it presents is sufficient to raise a presumption that the alleged facts are correct. Because Australia has not presented any evidence refuting this affirmative showing, the Panel should accept the evidence presented by the United States as reasonable estimates of the current and future demand in Australia for automobiles and automotive leather.

7.248 In response to questioning by the **Panel** about whether Australia agreed with the estimates submitted by the United States concerning the projected production of motor vehicles in Australia and the projected demand for cattle hides through 2000, **Australia** responded that it considered "that the

¹⁵¹ The United States calculated the A\$114.4 figure by annualizing Howe production based on its sales for the first three-quarters of the year (A\$85.8 million). The United States refers to Memorandum from Embassy of Australia to the Office of the United States Trade Representative, May 7, 1997, United States Exhibit 11.

¹⁵² The United States asserts that, if Howe's sales were to remain at their 1996/97 levels, Howe would generate A\$429 million in sales over the life of the grant program, entitling it to A\$21.5 million in grant assistance. Howe would need to generate an extra A\$171 million over the 3 3/4 year life of the grant program (bringing its total sales over the period to A\$600 million total) for it to earn the full A\$30 million; an average annual increase of A\$45.6 million (A\$171 / 3 3/4 years).

¹⁵³ According to the United States, given that Howe would need to increase its sales by A\$45.6 million a year to qualify for the entire amount of the grant (assuming A\$114 million in annual sales), Howe would have to also increase weekly production of 10,000 hides by 40 per cent or an additional 4000 hides per week to reach that sales goal.

¹⁵⁴ J. Schaffer, Chairman & Managing Director, Schaffer Corp. Ltd., "Howe Leather Announces \$300M in New US Contracts," June 18, 1998, United States Exhibit 47.

¹⁵⁵ Howe Leather, Dec. 1994, United States Exhibit 31; "Picking Winners," Business Review 1997, Oct. 13, 1997, United States Exhibit 32.

¹⁵⁶ Affidavit of Robert F. White, Senior Vice President, Eagle Ottawa Leather Company, United States Exhibit 27.

¹⁵⁷ Federation of Automotive Products Manufacturers, Vehicle Production Forecasts, March 1998, United States Exhibit 28.

¹⁵⁸ Affidavit of Robert F. White, Senior Vice President, Eagle Ottawa Leather Company, United States Exhibit 27.

question is not relevant to the issues before the Panel, since projected demand figures are quite unrelated to the issue of whether any of the measures is contingent upon export performance." Australia also considers that the Federation of Automotive Products Manufacturers projections are conservative. According to Australia, the medium-term outlook for the automobile market in Australia is buoyed by strong economic conditions but is also currently subject to another of other factors, including prevailing economic conditions in Asian markets, which potentially affect both exports and imports to Australia, as well as the transitional arrangements for the introduction of a goods and services tax. The current outlook is for stronger growth in domestically produced vehicles than was the outlook when the Federation of Automotive Products Manufacturers conducted its survey. However, Australia did not have "any other or more up-to-date public forecasts to provide to the Panel." Furthermore, Australia states that the evidence submitted by the United States relating to the projected demand in cattle hides rests "on several contestable assertions and assumptions." According to Australia, the current proportion of new vehicles ordered and/or sold containing leather seating and interior trimming could well be in excess of the 10 per cent penetration first estimated by the United States, and could perhaps even exceed the 15 per cent level later canvassed. Given that leather interiors as an option have grown from negligible levels over the past decade, there is scope for such growth to continue into the foreseeable future. Similarly, Australia asserts, there is scope for growth in the after-market for automotive leather, which is not well developed when compared with the United States market. However, Australia did not provide the Panel with any forecasts based on these different assumptions.

7.249 The **United States** notes that, although Australia states that the projected demand for automobiles in Australia as calculated by the Federation of Automotive Products Manufacturers is conservative, Australia states that it "does not have any more up to date public forecasts to provide to the Panel." According to the United States, the factual information concerning the projected demand for automobiles in Australia presented by the United States is therefore un rebutted.

7.250 Similarly, the United States observes that, although Australia questions the figures supplied with regard to the projected demand for automotive leather in Australia, it does not provide any alternative figures. The United States notes that a panel must accept a fact submitted to establish a *prima facie* case that is based upon evidence (1) which is sufficient to raise a presumption that the alleged fact or claim is correct; and (2) that has not been sufficiently rebutted by the opposing party.¹⁵⁹ In this case, the United States argues that the affidavit and the quotes from the Australian Federation of Automotive Product Manufacturers are sufficient to raise a presumption that the alleged facts are correct and because Australia has not presented any evidence to refute the United States' affirmative showing, the Panel must accept the evidence presented by the United States estimating the future demand in Australia for automobiles and automotive leather.

7.251 The United States submits that, given the large disparity between Howe's increased capacity and the domestic demand for its product, Howe's increased sales and production capacity will necessarily be targeted towards, and tied to, foreign markets. Even if the Australian market for automotive leather were to double between 1997 and 2000 (to almost 3,000 hides per week), this increased demand would take up less than 15 per cent of Howe's new production capacity. Clearly, the United States argues, for Howe to reach its sales goals and use its expanded capacity, it must increase its exports dramatically.

7.252 According to the United States, the anticipated increases in sales and production are consistent with promises Howe made in its bid for the replacement package. It has been reported that Howe "promis[ed] untold export riches (\$600 million over the four years to the 2000)" to the

¹⁵⁹ The United States refers to *Japan - Measures Affecting Agricultural Products* ("Japan - Agricultural Products"), WT/DS76/R, circulated to Members on 27 October 1998, para. 7.10.

Australian government in order to secure the new subsidies.¹⁶⁰ Specifically, Howe projected that its automotive leather sales would mushroom from \$88.6 million in 1997 to \$214 million by 2000, with the lion's share of the growth coming from exports.

7.253 **Australia** submits that the loan contract plainly has no possible connection with any sort of performance, let alone a tie to exports. Indeed, the United States has not even seriously tried to make a connection beyond questioning how the loan contract will be serviced. The loan contract itself provides the conditions under which the actual money was lent, including the assets of the parent company, ALH, being security for the loan and the terms under which payments are to be made by the parent company and Howe. Virtually all companies have loans as a matter of normal business practice, loans which have to be serviced and turned over as part of the normal cash flow of a company's operations. There is nothing particularly different about this loan. The loan contract was made on 9 March 1997. While it does extend to 1 February 2012, the government has no call on the money so long as the company makes repayments according to schedule. The level of sales is irrelevant so long as the company pays the government any monies owing, and the United States has not made any allegations or produced any facts to the contrary. How much the company produces and to whom it sells is irrelevant. The money is simply not recoverable except according to the loan contract, i.e. the repayments of principal and interest owing. There is no connection with sales, let alone exports, under the contractual relations between the company and the government.

7.254 With respect to the grant contract, Australia maintains that only the first two payments under the grant contract are measures before the Panel. These were both made by July 1997. The monies are not recoverable regardless of the actual level of sales by the company and so cannot be considered to be in some way in fact tied to exports. According to Australia, there is no way in which they could be linked in even the most tenuous way to future exports, let alone satisfy the stringent requirements for the "in fact" condition in Article 3.1(a) of the SCM Agreement. The first payment of A\$5 million was made following the signing of the grant contract. This was an automatic payment. It was not tied to anything, let alone export performance. The second payment of A\$12.5 million (the other measure before the Panel) was the maximum allowed. It was made on the basis that the company had satisfied its investment and sales targets on a best endeavours basis. There is no way that the company could have obtained more money regardless of how much it invested or sold.

7.255 In Australia's view, subsequent payments are not measures before the Panel. However, the maximum amount under the grant contract has been all but paid out, with the company exceeding its investment targets. The third payment was made on the basis of an assessment in July 1998 that the company had on balance performed satisfactorily on a best endeavours basis in respect of a combination of investment and production in 1997/98, as well as normal due diligence considerations such as whether the company was functioning properly. The government cannot take back that money provided that the company continues in business. The money has been paid out lawfully. The company could expand or reduce sales and the status of the payments under the grant contract would be unchanged. The money is gone and there is no connection with future sales, including sales for export.

7.256 The **United States** underlines that the terms of the assistance package and the limited size of the Australian market for automotive leather make clear that the subsidies are in fact tied to Howe's export performance. The fact that Australia thus far has paid out the maximum amounts in grants allowed under the assistance package -- coupled with the fact that Howe's business is almost exclusively dedicated to exporting -- indicate that Australia, in effect, has provided Howe with substantial financial benefits based on its export performance.

¹⁶⁰ "Sacred Cows vs. The Hide of Howe," The Weekend Australian, Sept. 20-21, 1997, p. 52, United States Exhibit 22.

7.257 In respect of Australia's claim that the grants in the assistance package are calculated based on Howe's total production, not on exports, and therefore are not tied to export performance, the United States asserts that, given the large disparity between Howe's increased capacity and the domestic demand for its product, its increased production capacity resulting from the assistance package will necessarily be targeted towards, and tied to, foreign markets.

7.258 In respect of Australia's argument that the loan had no conditions for disbursement and therefore is not tied in any way to exports, the United States asserts that, first, although the loan contract is a separate measure, it is inextricably linked to the grant contract. Both these measures, which were announced at the same time, were provided to Howe to compensate for its exclusion from the export subsidies under the ICS and EFS programmes. In addition, the United States points out, Australia states with regard to the loan that "the level of sales is irrelevant so long as the company pays the government any monies owing...." The Australian government has stated publicly that the new subsidies were the minimum amount necessary to ensure the viability of the company and that "any amount less than provided by the assistance package would in all likelihood have seen the company fold." In the view of the United States, given the fact the company has no choice but to increase its exports in order to increase its sales given the limited size of the domestic market, the fact that the company exports over 90 per cent of its production, and the acknowledgement by the Australian government that the company's survival depended upon the new subsidies, the viability of the loan is necessarily contingent upon Howe's export earnings. If Howe does not export, the Australian government will not be repaid. Consequently, the loan is "in fact tied to Howe's actual or anticipated exportation or export earnings" as provided in Article 3.1 of the SCM Agreement.

7.259 According to the United States, it is also significant that the replacement subsidies provided to Howe have not been provided to other Australian producers of automotive leather for the Australian market. This reinforces the notion that the replacement package is not part of a general domestic subsidy programme intended to benefit the leather industry, but instead is more narrowly focused on a unique Australian business that overwhelmingly exports its products.

7.260 **Australia** responds by stating that it is unclear what is meant by the statement of the United States that the loan contract is "inextricably linked to" the grant contract, given that the time periods and conditions are quite different. Moreover, this does not explain how under Article 3.1(a) of the SCM Agreement, there is any justification for looking at a number of measures simultaneously to determine their WTO status. For a violation case, each measure before the Panel needs to be looked at separately, and the United States has not sought to rebut that through argument. Australia maintains that the loan is a separate measure that needs to be assessed separately in its own right.

7.261 With respect to the loan, Australia submits that there is no basis for the United States' assertions that "if Howe does not export, the Australian government will not be repaid and that, consequently, the loan is "in fact tied to Howe's actual or anticipated exportation or *export earnings*."", and no argument is presented by the United States to support them. In fact, there is no commercial or legal basis on which the loan contract could be interpreted in this way. The loan is to ALH and Howe. The loan is secured by ALH. The servicing of the loan contract will not commence before 2003. Precisely how the borrowers finally acquit the loan is a matter solely for the borrowers themselves, and there is nothing to support a claim that the loan can only be serviced through income generated from export sales, in particular export sales of automotive leather. The ability of ALH to repay does not rely solely on the domestic or export markets for automotive leather. These are currently important elements of the Group's operations, but it is impossible to say what the markets or the product mix will be when the major repayments are due. The loan contract determines the interest rate payable and the schedule for repayments of principal. It does not prescribe how ALH will fund the repayments or from where it will source these funds. There is no tie to sales or export performance or to the product or products concerned.

7.262 Australia asserts that the continued commercial viability of the ALH Group, as with all firms, depends on sales in all markets and not just export markets. In Howe's case specifically the company has two main facilities: the tannery at Rosedale; and the finishing plant at Thomastown. The tannery produces wet blue hides and crust leather. These can go to many types of leather, both on domestic and export markets. While at the moment the production of Rosedale is going in the main to Thomastown, technically there is nothing fixed about this. In the longer term if the market changed, hides could go for other than automotive leather at Thomastown. Similarly, while some of the finishing and cutting machinery is adapted to the production of automotive leather, this is by no means fixed. The works can, and currently do, produce leather other than automotive leather. If the market for automotive leather changed, then the output from both Rosedale and Thomastown would change. This is the way all businesses work and adapt. Australia observes that the loan contract does not prevent Howe from producing and selling other products. It is impossible to say what the nature of the fashion and global market for automotive leather and other leathers will be by the end of the loan contract's repayment period. Certainly, there is nothing to suggest that it has to be paid back through production, let alone exports, of automotive leather.

7.263 Australia asserts that, regarding the first two payments under the grant contract (the only ones that Australia considers are before the Panel), the first payment was simply A\$5 million, while the second payment was capped at A\$12.5 million and this was paid in full. The first payment was made in March 1997 following the completion of the grant contract in March 1997. This was simply a flat payment and not subject to any assessment of investment or sales. It was not contingent on the company doing anything and so could not be linked in any way to export performance. The second payment was made in July 1997 against investment as well as sales. The maximum amount was paid of A\$12.5 million because the government assessed that the company had used its best endeavours regarding investment and production in 1996/97. There was no way in which more could have been paid regardless of the actual amount of investment or sales. Australia argues that further payments are not before the Panel. However, the third payment was again made on the basis of an assessment in July 1998 that the company had on balance performed satisfactorily on a best endeavours basis in respect of a combination of investment and production in 1997/98, as well as normal due diligence considerations such as whether the company was functioning properly. Australia asserts that business confidential information it provided to the Panel supports its position that the payments to Howe under the grant contract were not based on Howe's export performance.

7.264 The **United States** considers that Australia's arguments regarding the "automatic" nature of the first grant payment and the fact that it preceded performance under the grant contract is flawed for two reasons. First, this payment, like the other payments, was made pursuant to the single grant contract which is tied to Howe's export performance. The facts in this case -- including the prior "in law" automotive and textile export subsidies, Howe's exceptional export performance, the small size of the Australian market, the statements by high level Australian government officials and Howe -- prove that the grant contract, which subsumes the grant payments, was provided in anticipation of exportation and export earnings. Furthermore, it is immaterial that this initial payment was automatically made prior to Howe's performance under the grant contract. Footnote 4 encompasses subsidies "tied to ... *anticipated* exportation or export earnings" (emphasis supplied by the United States); thus, exportation can follow the granting of the benefit. To be actionable as a prohibited subsidy, the facts need only demonstrate that, like in this case, the subsidy was provided because of foreseeable or probable export conduct.

7.265 Further, the United States contends, Australia asserts that the second and third grant payments are not "in fact" export subsidies because the grant contract does not require Howe actually to achieve any sales targets; instead, Howe only has to use its "best endeavours" to do so. The strict prohibition against export subsidies cannot, however, be so easily circumvented. Clearly, Australia conferred these payments in the expectation that Howe would attempt substantially to increase its exports. That Australia would provide grant payments even if Howe did not fulfill its ambitious promises only

underscores the extent of Australia's commitment to this export-oriented company. In other words, regardless of whether it actually met its performance commitments, Howe would receive additional grant payments because any increased production would – given the small size of the Australian automotive market – necessarily be shipped abroad.

7.266 With respect to the grant contract, **Australia** asserts that Article 3.1(a) and footnote 4 of the SCM Agreement are about a panel reaching the conclusion demonstrated through an objective assessment of facts that the granting of a subsidy is contingent upon export performance, even though it may not be required in law. This contrasts sharply with the situation under the grant contract, where the official responsible for administering the Australian government's obligations under the contract is required *in law* to consider total sales and so does not discriminate between domestic and export sales. Indeed, Australia states, the United States has not even made an allegation that the administration of the grant contract, i.e. the actual disbursement of the grants, is in any way contingent on export performance.

7.267 Australia notes that the United States seems to consider that providing assistance to only one producer of automotive leather in Australia is significant. The fact is that Howe is the automotive leather industry in Australia. There is nothing in the WTO Agreement that says that Members cannot provide assistance to such firms, and the United States has not made any legal argument about this. This is a natural occurrence in a small country. Similarly, Australia points out, the United States seems to consider that it is significant that this company is the only firm to be benefiting from the arrangement. Again the history of this is clear, i.e. the arrangements cover just automotive leather with Howe being the only significant producer in Australia.

7.268 The **United States** repeats that the terms of the assistance package and the limited size of the Australian market for automotive leather make clear that subsidies are in fact tied to Howe's export performance. The Australian government conditioned receipt of the grant monies upon Howe dramatically increasing its sales and meeting certain capital investment requirements.

7.269 **Australia** responds that the United States has not demonstrated its assertion that the Australian government conditioned receipt of the grant money upon Howe dramatically increasing its sales. Indeed, the record shows that Howe simply received the first payment (\$A5 million) on execution of the grant contract. The second payment of \$A12.5 million was on the basis of the next three months, which was hardly time for a dramatic increase in exports. The third payment was on the basis of 1997/98, and again the record shows that this was not on the basis of increased sales of automotive leather. Australia bases these assertions on business confidential information it provided to the Panel.

7.270 Australia states that, in referring to "conditioned receipt of the grant money", the United States again appears to have moved from its position that the issue is the information available at the time of granting the grant contract to the issue of the basis for granting the individual payments. Otherwise it must be saying that the Australian Government did not care what the actual outcomes would be – if so, the standard of footnote 4 of the SCM Agreement can hardly have been met.

7.271 In addition, Australia submits, "conditioned receipt" is an interesting phrase. "Conditioned" means "subjected to conditions or limitations."¹⁶¹ Thus, this phrase can only refer to the granting of the payments after the first payment and not to anything else. Clearly, the granting of the loan contract, the money under the loan contract, and the grant contract were not subject to any requirements. Moreover, the first payment under the grant contract was not subject to any conditions. In addition, the record shows that there was no such "conditioned receipt" related to exports. The United States asserts that the capital expenditure implies an enormous increase in

¹⁶¹ *Shorter Oxford English Dictionary*, third ed.

production. The capital expenditure was on a new finishing plant and on a tannery. A tannery does not increase Howe's capacity to produce automotive leather. It aims to improve Howe's efficiency as an integrated operation. However, Howe sourced hides from other companies before the plant was established and still does. Some semi-processed hides are even imported. The capacity for producing automotive leather depends on the finishing plant. This was a replacement for an old plant. It was not an additional plant. Its purpose was to increase efficiency not to increase capacity. The efficiency dividend has had the effect of increasing practical capacity by about a quarter, but capacity does not reflect production levels. In the real world, plants rarely run at anything like the full theoretical capacity for extended periods of time. Indeed, a maximum weekly capacity figure cannot be directly translated into annual figures. The United States has simply taken an old press figure on production levels, derived a capacity figure, and come to the conclusion that production has doubled.¹⁶²

7.272 The **United States** contends that, at the time the Australian government agreed to provide the assistance package, the Australian domestic automobile market could not absorb all of Howe's production, let alone any increased production. To the United States, the fact that Australia thus far has paid out the maximum amounts in grants allowed under the assistance package -- coupled with the fact that Howe's business is almost exclusively dedicated to exporting -- strongly indicates that Australia provided Howe with substantial financial benefits based on its export performance.

7.273 **Australia** responds that these arguments do not demonstrate that the granting of a subsidy was contingent upon export performance. Indeed, the record shows quite the contrary. The grants paid to Howe were not based on Howe's export performance. The final sentence of the United States' arguments in the previous paragraph -- "[t]he fact that Australia has thus far paid out the maximum amounts in grants ..." -- underscores that the United States is moving between its two stools of whether it is talking about the payments or the grant contract.

7.274 The **United States** insists that, because of the large disparity between Howe's increased capacity and the domestic demand for its product, Howe's increased production capacity resulting from the assistance package will necessarily be targeted towards, and tied to, foreign markets. The Australian government realized that Howe could not meet its "sales target" -- that is, its expanded "export" goals -- unless it substantially expanded its capacity. Thus, the capital investment made by Howe was needed before it could achieve the anticipated export levels. Simply saying that this money was tied to production and spent on Howe's investments is therefore not sufficient to break the link between the export-nature of these substantial benefits.

7.275 **Australia** responds that, clearly, if a firm exports, then in a trivial sense, some of its sales go to foreign markets. However, this is not the same as being "tied to, foreign markets" as stated by the United States. The grant contract shows that that was not the case. On the issue of investment, Australia has informed the Panel, and the United States has not denied, that it was at the insistence of the United States that the company was obliged to implement an investment programme amounting to much of the A\$30 million of the grant contract. This was done to meet the wishes of the United States not with any idea of linkage to exports in mind.

7.276 The **United States** asserts that the fact that export promotion is merely one of several objectives for a programme does not mean that a programme is not an export subsidy. Article 3.1(a) of the SCM Agreement specifically notes that export subsidies are prohibited when the subsidies are contingent upon export "whether solely or as one of several other conditions." Clearly, the United States argues, other conditions may be imposed on the recipient, but so long as the benefit is tied to

¹⁶² Australia disputes the United States argument on this point, referring for support to business confidential information that it provided to the Panel regarding Howe's sales.

exports, an export subsidy still exists. Indeed, in many instances, a subsidy may have more than one objective. As Australia has admitted in this case, the subsidy programme was given for two reasons: (1) to allow Howe to increase its investment; and (2) to ensure that Howe would reach its "sales" (or export) targets.¹⁶³ Thus, nothing in the SCM Agreement indicates or suggests that subsidy programmes must only have a single goal of promoting exports. The express language of the Agreement makes this clear. Rather, if one component of the subsidy programme is that the aid is tied to actual or anticipated exports, then the programme is an export subsidy.

7.277 The United States repeats that, although the loan contract is a separate measure, it is inextricably linked to the grant contract. Both these measures, which were announced at the same time, were provided to Howe to compensate for its exclusion from the export subsidies under the ICS and EFS programmes.¹⁶⁴ Finally, the Australian government stated publicly that the total replacement package was the minimum amount necessary to ensure the viability of the company and that "any amount less than provided by the assistance package would in all likelihood have seen the company fold."¹⁶⁵ Clearly, the Australian government considers that the loan and the grant were always part of a single benefit package given to Howe.

7.278 **Australia** notes that the United States recognizes that the loan contract is a separate measure and does not deny that the two contracts (i.e. grant and loan) are legally separate instruments. Under Article 3.1(a) of the SCM Agreement, a panel is required to look at each subsidy separately to determine whether it meets the standards set out in that article. There is no provision for cumulating subsidies as there is under Parts III and V of the SCM Agreement. The Panel's terms of reference are clear that the loan contract is a separate measure and so needs to be looked at separately on its own merits.

7.279 According to Australia, the language of the contracts is simply the standard legal terminology used in contracts by the Australian Department of Industry, Science and Resources (previously Industry, Science and Tourism) and does not represent any legal relationship between them that would result in a nexus under Article 3.1(a) of the SCM Agreement. To the extent that the United States argues on the basis that the two contracts replaced the application of the ICS and EFS to automotive leather, then it is not logical to consider the two contracts together. The loan contract runs until 2012. The grant contract runs until 2000 for auditing purposes but its payments are on the basis of the period to mid-1998. On the other hand, the ICS and EFS terminate in 2000. Following the termination of the ICS in mid-2000, automotive leather is to be covered by the new general textile, clothing and footwear industry arrangements.

7.280 According to the **United States**, it is also significant that the replacement subsidies were designed and structured specifically for Howe after an accounting firm was commissioned to study the issue¹⁶⁶ and that no similar subsidies have been provided to other Australian producers of automotive leather for the Australian market. This reinforces the notion that the replacement package is not part of a general domestic subsidy programme intended to benefit the leather industry, but instead is more narrowly focused on supporting a unique Australian business that overwhelmingly exports its products.

7.281 In response, **Australia** states that the arrangements were designed and structured to try to meet the requests of the United States government. The circumstances of why these applied to

¹⁶³ The United States cites certain paragraphs of Australia's first written submission in this regard. Australia states that it did not say this and that the United States has misunderstood its arguments.

¹⁶⁴ The United States also referred to certain business confidential information in making this argument.

¹⁶⁵ United States Exhibit 18.

¹⁶⁶ *Ibid.*

automotive leather alone are clear and there are no other substantial, dedicated producers of automotive leather in Australia. In particular, there are no other producers of automotive leather for the original equipment manufacturers (OEM) market.

7.282 The **United States** asserts that Australia's argument that the United States has failed to demonstrate an "in fact" export subsidy is without merit. The argument of the Australian government that the grant and the loan are not "tied" to exports because Howe would not be required to return either the grant or loan if the company ceased exporting is both factually and legally incorrect. First, Howe was principally an exporter when the initial funds were given and it continues to export in significant volumes. As the Australian government indicated, Howe met its "sales target" as established by the grant contract, and the second and third payment of the grant were in fact dependent on Howe having met these goals. Thus, any export goals the Australian government may have expected from Howe were being met.

7.283 **Australia** states that these comments must arise from a misunderstanding by the United States. The relevant paragraphs to which the United States refers are in respect of the loan contract. The loan contract has nothing about sales, let alone exports. Moreover, there is nothing that says where the money has to come from to service the obligations of ALH (including Howe) under the loan contract. There is nothing that ties the servicing of the loan contract to automotive leather, let alone to exports of automotive leather. The other provisions cited by the United States are about the grant contract and are about the past rather than the future, i.e. about 1996/97 and 1997/98. These payments were not based on Howe meeting any "export goals". The success or otherwise of Howe in making sales of automotive leather in the future, including to overseas markets, is not relevant. If Howe is unable to sell more automotive leather, or indeed if sales happened even to fall, there would be no recovery of the monies. The future performance of the company is not an issue. In addition, the grant contract was about investment and sales by the company and not just sales of automotive leather, i.e. it was not limited to automotive leather. There is clearly no connection to future sales of automotive leather, let alone any aspect of the grant contract being contingent upon export performance.

7.284 The **United States** argues that whether the grant or loan is recoverable if the recipient ceases to export is not dispositive of whether the programme is an "export subsidy" in law or in fact. Rather, the dispositive question is whether, *at the time* the subsidies were granted, they were tied to the *actual or anticipated* exportation or export earnings. In this case, the answer to this question is manifestly "yes." These funds were not given to just *any* company with the potential to increase its investment and sales. The funds were given to a company who was well known for its aggressive export plans and its past performance of exporting 90 per cent of its sales. Moreover, these funds were given to compensate Howe for losing two "in law" export subsidies, with the publicly stated purpose of promoting exports, and were given to Howe to increase its capacity even though the Australian market could in no way absorb Howe's expanded capacity to produce automotive leather. The United States maintains that thus, the overwhelming evidence -- evidence that was never rebutted by Australia -- demonstrates that the grant and loan were tied to anticipated exports and that the Australian government's expectations in this respect were not disappointed.

7.285 **Australia** contends that the United States appears to be arguing here about the conditions of the granting of the loan contract and the conditions of the granting of the grant contract. The United States is arguing that the fact that an enterprise exports and is anticipated to continue to export is equivalent to the granting of a subsidy being *tied* to exports or the anticipation of exports. The two concepts are not the same, apart from this linkage being ruled out by footnote 4 of the SCM Agreement. The acceptance of such a linkage would mean that giving a subsidy to any enterprise that is dependent on export markets would be prohibited. Conceptually, a company might export less than

50% of its production and still be financially dependent on exports. Indeed, this would often be the case.

7.286 Australia submits that, in the case of the grant contract, the United States appears to be arguing that the conditions under which the actual payments were made is irrelevant. This can only mean that the United States is saying that it does not matter on what basis decisions were taken to pay the money to the company. As a result, the United States is falling back on a level of exports test. This is not the standard set out in footnote 4 of the SCM Agreement. It does not demonstrate the *tie* required to conclude that the granting of the grant contract was contingent upon export performance.

7.287 According to the **United States**, the Australian government's suggestion that subsidies can only be "tied" to exports if the monies are refundable if export goals are not met would effectively negate the explicit language of the SCM Agreement. Footnote 4 to Article 3.1(a) of the SCM Agreement states that an export subsidy in fact exists "when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or *anticipated* exportation or export earnings"(emphasis supplied by the United States). The ordinary meaning of the term "anticipate" is "expect, foresee, or regard as probable."¹⁶⁷ The ordinary meaning of the term is incompatible with Australia's argument that a subsidy would only be conferred upon actual exportation or lost if the recipient is unable to demonstrate that the goods were exported.

7.288 **Australia** responds that the standard of footnote 4 of the SCM Agreement requires that the *tie* to actual or anticipated exportation or export earnings must be demonstrated. Australia has not said that this meant that there had to be a requirement for monies to be repaid if anticipated exports were not achieved. Presumably, if there was a legal requirement in respect of anticipated exports, then the subsidy would be in law contingent on export performance. There are many ways in which this could be handled administratively. For example, the administration might want to see delivery contracts for exports before paying money out or might penalize a company by reducing future payments. This goes to the crux of what is meant by "in fact" in Article 3.1(a) of the SCM Agreement. This is supposed to be about administration of schemes whereby payments are contingent on export performance while not being legally contingent upon export performance. In this particular case, the legal nature of the contracts specify the terms under which the monies are paid out and so remove the scope for such administrative action.

7.289 In response to questioning from the Panel, Australia asserted that the phrase "anticipated exportation or export earnings" has to be read not only in the context of the full phrase "actual or anticipated exportation or export earnings", but also in the context of the whole of Article 3.1(a) and footnote 4 of the SCM Agreement. The phrases "actual exportation or export earnings" and "anticipated exportation or export earnings" relate to the timing of the payments contingent upon export performance. The two phrases cover concrete exports that have been made or will be made, respectively. The distinction between exportation and earnings relates to product volumes and earnings to cover all variations. For Australia, this underlines that the discipline is in respect of real export performance, and not some more far-reaching rule based on level of exports as proposed by the United States.

7.290 The **United States** asserts that, in making its assertion that the benefits were not "tied" to exports, the Australian government has misinterpreted a portion of the United States' argument. Australia suggests that the United States is arguing that "the cap" on the grant of A\$30 million subsidy makes the measure prohibited. The United States is not arguing that the cap on the amount of the grant somehow affected the nature of the subsidy. Rather, as the Australian government itself indicates, the continued payment of the grant was tied to the volume of "sales." Given that the overwhelming majority of these "sales" could only be exports because of the small domestic market

¹⁶⁷ *The Concise Oxford Dictionary*, Clarendon Press, 8th ed.

for automotive leather, the Australian government's own admission reveals that in fact, the grant was "tied" to exports.

7.291 **Australia** counters that the statement on which the United States comments in the above paragraph simply pointed out the false logic in the United States' argument about the company needing to increase its sales to A\$600 million in order to obtain the full A\$30 million and so this cap apparently meant that it was an export subsidy. The hypothetical point was made that Article 3.1(a) of the SCM Agreement is not supposed to prohibit bounty payments (i.e. payments based on the amount of production or sales). Many bounty schemes are uncapped and the more that is produced, the more the monies paid out. That does not make them prohibited. It would be absurd to have the situation where a cap on the amount of money suddenly made a bounty prohibited, which seemed to be the logic of the United States' position. This particular case is not about a bounty and the company did not have to achieve the levels of sales being talked about by the United States.

7.292 The **United States** contends that the Australian government's attempt to distort the facts and arguments raised in this case and apply them to some potential future situation should not dissuade the Panel from carefully analyzing the facts in this case. Despite Australia's claim, there would be no bias against smaller WTO Members if the Panel rules in favour of the United States in this proceeding. This case does not turn on the fact that Australia only has one exporter of automotive leather. If 100 companies had been excluded from Australia's textile and automotive leather programmes; and if those companies had high export levels; and if each then received the same grant and preferential loan bestowed on Howe; and if high-level government officials stated that the replacement subsidies were being given to ensure the continuation of their exports; and if the Australian automotive leather market could not absorb additional production; then an "in fact" export subsidy would still have been conferred – even though 100 companies were involved. In other words, this case does not turn on the fact that only one exporter received this benefit. Rather, the relevant fact highlighted by the United States was that only the exporter of leather received this benefit, not other Australian leather tanners that were not exporting. If the Australian government was interested simply in expanding its leather industry in Australia, presumably it would have provided benefits to all leather tanners, not just the one exporter. Thus, the Australian government's attempt to apply the facts of this case to a situation involving smaller WTO Members is not valid. As this demonstrates, smaller WTO Members will not be disadvantaged by an affirmative finding in this proceeding.

7.293 **Australia** maintains that the small country issue is about the relative size of domestic markets and the economies of scale in manufacturing processes. In a small country such as Australia, there would be a limited range of manufactured products where there would be 100 companies producing that product let alone with each having a high level of exports. On the other hand, in a country the size of the United States, it might be more likely for there to be 100 manufacturers of a particular product line, though it would be limited by the nature of the industry. For example, the automotive leather industry is highly concentrated in the United States.

7.294 Australia states that the United States' argument about other leather companies not receiving the same arrangements is irrelevant, given the background to this case. Automotive leather will be part of the new general textile, footwear and clothing industry arrangements due to come into force on 1 July 2000.

7.295 The **United States** argues that Australia's concern about the same subsidy being treated as a domestic and export subsidy is unwarranted. In determining the existence of an "in fact" export subsidy, a panel must consider all of the facts surrounding the provision of the aid. It should look at whether and to what extent an industry is currently engaged in exporting and whether the proposed aid is provided in order to encourage increased exports. The fact that some entities in an industry export while others do not is just one of many facts that the Panel should consider in making its

decision. If, on the basis of all of the facts surrounding the granting of the aid, the Panel makes an affirmative decision, the aid will be treated as an "in fact" export subsidy – regardless of whether it is provided to an exporting or non-exporting entity. In other words, all recipients will be treated the same once the decision on the nature of the subsidy is rendered.

7.296 To **Australia**, the previous paragraph highlights the inconsistency of the United States' position with the SCM Agreement and underlines the risk of moving away from normal rules of treaty interpretation in examining the meaning of Article 3.1(a) of the SCM Agreement. The United States says that 'the aid will be treated as an "in fact" export subsidy -- regardless of whether it is provided to an exporting or non-exporting entity.' Thus, the United States admits that the logic of its argument is that the provision of a subsidy to an enterprise that does not even export anything at all could be prohibited as an export subsidy. There is no way in which a normal reading of the text could reach the conclusion that the granting of a subsidy to a non-exporting enterprise is contingent upon export performance. That sort of conclusion would be inconsistent with Article 3.2 of the DSU that sets out that: "[t]he dispute settlement system of the WTO is a central element in providing *security and predictability* to the multilateral trading system." (emphasis supplied by Australia)

7.297 Australia submitted information to the Panel concerning the specific percentage of Howe's total sales attributed to exports in 1997/98. Australia designated this information as "business confidential". The **United States** questions the specific percentage of Howe's total sales attributed to exports in 1997/98 that were submitted to the Panel, and points out that Australia refuses to provide the sales figures for Howe and does not otherwise explain how the numbers presented were calculated or provide any supporting documentation. As a result, the Panel is left without any means for assessing the probative value of Australia's statement. Furthermore, Australia cannot pick and choose which confidential information the Panel should rely on. Unless Australia produces all of the information requested, the Panel should disregard any assertions based on confidential information strategically selected by Australia for presentation to the Panel. In any event, Australia's belated assertion regarding Howe's level of exports seems questionable given the evidence the United States has submitted. These sources¹⁶⁸ indicate that, in 1996, when Australia was developing the compensation package, Howe's exports accounted for 90 per cent of its sales. Australia has provided no evidence to refute that fact. Instead, Australia has provided unsubstantiated information regarding Howe's export levels for the year 1997/98, which began on 1 July 1997, months after the replacement package was provided. However, the relevant number is the level of exports at the time the government made the decision to grant the subsidies. In this case, the undisputed evidence shows that Howe exported over 90 per cent of its production at that time.

7.298 Australia provided, as business confidential information, a breakdown of sales and exports over the three years 1995/96, 1996/97 and 1997/98. Australia asserts that this information shows

¹⁶⁸ The United States refers to the following: "...and the Hide of One Australian Tanner", Australian Financial Review, November 18, 1996, p. 18 ("In 1988, we exported 7 per cent of our production; now we are exporting 90 per cent worth over £80 million a year' says the firm's managing director, Chris Heysen), United States Exhibit 3; "Howe leather wins wheels award", World Leather, February/March 1997 ("The company [Howe] has increased its exports from 7% to 90% over the last eight years"), United States Exhibit 4; "Major Headache for the Howard Government" A\$ Adding Value, July 5, 1996 ("Howe's exports have risen from less than 10 percent of sales in 1988, to nearly ninety percent of sales"), United States Exhibit 5; "Trade Showdown", Herald Sun, November 20, 1996 ("The company was a shining light with 90 percent of Howe's production being for exports"), United States Exhibit 30; "Picking Winners", Business Review, October 13, 1997 ("Howe Leather exports in 1996/97, up from \$55 million to \$80 million, represent 90 percent of turnover"), United States Exhibit 32.

the trend of sales and underlines the basis on which the payments were made. Australia asserts that this information shows that the percentage of Howe's total sales for exports were significantly lower than asserted by the United States and demonstrates that the sources of United States data and the type of procedures of imputation used by the United States are fundamentally unreliable. In Australia's view, it also demonstrates that the "best endeavours" clauses of the grant contract are not tied in any way to achieving specific sales, let alone export levels. For Australia, this data also underlines the misunderstanding by the United States of the nature of the sales figures under the grant contract -- in particular, that they are not limited to automotive leather.

Factors other than level of exports

7.299 **Australia** observes that the United States says that: footnote 4 to Article 3 of the SCM Agreement "does not preclude consideration of the level of exports, it simply proscribes finding a prohibited export subsidy based solely on the level of exports"¹⁶⁹ (emphasis supplied by Australia). Australia argues that this can only mean that the United States agrees that it has to produce facts other than Howe's level of exports to demonstrate that the granting of each of the measures before the Panel is in fact tied to export performance. However, Australia asserts, the United States has not produced such facts. Its argument (which Australia rejects) rests on information regarding quite different prior measures (EFS/ICS) and media reports about a company that exports. This underlines the problem behind interpreting this provision to allow some conceptual examination of the level of exports at all. The level of exports of a company or industry depend on a wide range of factors often specific to the industry or the country that have nothing to do with any particular commercial policy of the government. The availability of export markets and the most profitable product mix can also change quickly as a result of factors quite divorced from any particular governmental assistance measure. If the facts other than the level of exports are sufficient to demonstrate that the granting of a subsidy is in fact tied to export performance, then there is no need to look to the level of exports. If they are not sufficient, then the measure should be found to be in conformity.

7.300 In the view of Australia, a panel's job is not to make subjective judgements about the factors that may influence a company's decisions to export or its success as an exporter. Rather, a panel has to make objective rulings on the basis of facts as to whether the granting of a particular subsidy provided to a company is contingent upon that company's export performance. Footnote 4 of the SCM Agreement requires that the facts demonstrate that the granting of the subsidy is in fact tied to export performance. It does not call for the Panel to make a judgement about the weight of circumstantial evidence regarding the trade effects of a measure. Whether the granting of a subsidy is contingent upon export performance is not a function of the level of exports of a company but of the facts about the granting of the subsidy.

7.301 The **United States** maintains that, in this case, the level of Howe's exports is just one fact among many that, when considered together, demonstrate that the replacement subsidies, like the subsidies Howe enjoyed under the prior *de jure* export subsidy programmes, are prohibited export subsidies. In the view of the United States, its proffering of Howe's current high level of exports and its aggressive export plans goes to the heart of an "in fact" subsidy determination. The United States is not attempting to demonstrate the adverse "trade effects" of a subsidy that has already been granted, i.e., what happened *after* the assistance was bestowed. Rather, the United States proffered evidence of Howe's high level of exports to show what Australian government considered *at the time* the aid was given. Australia's knowledge of Howe's dependence upon exports and Howe's future plans at the time the aid was given is strong evidence that the assistance was tied to export performance within the meaning of footnote 4.

¹⁶⁹ *Supra*, para. 7.127.

7.302 The United States submits that it has presented substantial evidence demonstrating that the "granting" of the subsidies at issue was in fact tied to Howe's actual or anticipated exportation of export earnings. The United States asserts that, in an effort to avoid the prohibition in Article 3 of the SCM Agreement and distract the Panel from the facts, Australia mischaracterizes the extent of the United States' evidence by focusing entirely on Howe's level of exports. The United States' case clearly does not hinge entirely on the fact that Howe was exporting 90 per cent of its sales at the time Australia conferred the grant and preferential loan. While this high level of exports is an important fact for the Panel's consideration, it was only one of many significant facts demonstrating that the aid was tied to Howe's actual or anticipated exportation or export earnings within the meaning of Article 3.1(a), footnote 4 of the SCM Agreement. Such facts included the following:

- (a) The replacement package was specifically and explicitly designed to compensate Howe for its exclusion from two "in law" export subsidy programmes that had helped transform Howe into a major exporter;
- (b) The Australian government knew of, and in fact created, Howe's reliance on exports;
- (c) The recognized purpose of the replacement package by both the Australian government and Howe – like the "in law" export subsidy programmes that preceded it – was export promotion;
- (d) Howe had aggressive export plans;
- (e) Howe must significantly increase its sales to receive the full A\$30 million grant for which it is eligible; however, the Australian leather market is too small to absorb Howe's current -- much less, its increased -- production;
- (f) The only way that Howe could increase its sales and utilize the expanded production capacity that it has acquired as a result of the replacement package is to significantly increase its exports; and
- (g) The replacement package was provided only to Howe, who exports virtually all of its production, and not to any leather manufacturer that supplies the domestic market

7.303 The United States argues that Australia fails to counter any of the United States' factual assertions with facts that would undermine their credibility and asserts that the Panel should note the variety and volume of sources relied upon by the United States in this case.¹⁷⁰

7.304 The United States recalls that, as noted by the recent panel in *Japan - Agricultural Products*, a panel must accept a fact submitted to establish a *prima facie* case that is based on "evidence (1) which is sufficient to raise a presumption that the alleged fact or claim is correct and (2) that has not been sufficiently rebutted by the opposing party."¹⁷¹ Once a *prima facie* case has been made, the burden of proof shifts to the responding party.¹⁷² As the Appellate Body stated:

...it is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defense. If that party adduces

¹⁷⁰ Also see the United States arguments in this regard, *supra*, paras. 7.30-7.31.

¹⁷¹ WT/DS76/R, circulated to Members on 27 October 1998, para. 7.10.

¹⁷² Panel Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/R, WT/DS48/R, adopted 13 February 1998, para. 8.51.

evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.¹⁷³

7.305 The United States submits that the evidence presented by it, none of which has been refuted by Australia on the merits, establishes a *prima facie* violation of Article 3 of the SCM Agreement. Accordingly, the burden has shifted to Australia to demonstrate that the replacement subsidies were not in fact tied to Howe's export performance. Australia has presented no evidence and has failed to rebut the United States' affirmative showing. Instead, Australia relies on the argument that the Australian government did not intend to violate the SCM Agreement and that, for various unsound reasons, the Panel should simply ignore almost all of the relevant facts in this case. Australia insists that the compensation package is WTO-consistent because Australia claims it is. In the view of the United States, a review of the relevant evidence demonstrates to the contrary.

E. REMEDY

7.306 **Australia** submits that, in the event that the Panel finds that a measure was or is inconsistent with Article 3.1(a) of the SCM Agreement, it considers that the Panel should not make any suggestion on how the Australian government should bring itself into conformity with Article 3.1(a) of the SCM Agreement.

F. TIME PERIOD FOR IMPLEMENTATION

7.307 **Australia** asserts that, in the event that the Panel finds that a measure was, or is, inconsistent with Article 3.1(a) of the SCM Agreement, then the Panel would need to include in its recommendations the time period which Australia has to bring itself into conformity with Article 3.1(a).

7.308 According to Australia, the central problem is that Australia does not know whether the Panel will find that any measure was inconsistent, whether any measure is inconsistent, what measure might be involved, and critically why it might be considered to be inconsistent. In the absence of the Panel's views, it is impossible to make an informed submission in this regard.

7.309 Australia states that the drafting of this provision was done against the background that the PGE would have come to its conclusions and reported to the panel. The panel would then make a recommendation on the time period. This would have involved the parties making submissions on the basis of knowing the precise findings and reasoning that would appear in the panel's Report. That at least made some sense. The draft Rules of Procedure for the PGE¹⁷⁴ envisaged that it would report to a panel 46 days after it had been asked for assistance. This would allow the panel to address the issue in the context of submission from the parties.

7.310 Accordingly, Australia argues this Panel should give the parties, in particular Australia, the right to present arguments about what would be the appropriate time period once the Panel's views are known. The most appropriate time would be after the receipt of the Interim Report. Failing that, Australia submits that the Panel should provide for a period for implementation of 7.5 months.

¹⁷³ Panel Report, *Japan - Film*, WT/DS44/R, adopted 22 April 1998, para. 10.29, citing Appellate Body Report, *United States - Shirts and Blouses*, WT/DS33/AB/R, adopted 23 May 1997, p. 14.

¹⁷⁴ G/SCM/W/365/Rev.1, 24 June 1996, Rule 12.2.

VIII. INTERIM REVIEW

8.1 On 15 March 1999, Australia and the United States requested the Panel to review, in accordance with Article 15.2 of the DSU, precise aspects of the interim report issued to the parties on 8 March 1999. Neither party requested a meeting with the Panel.

8.2 Australia requested a clarifying change to footnote 1, paragraph 1 of the Report. The Panel made this change. Australia also questioned the accuracy of a sentence in paragraph 2.3 of the Panel Report concerning the calculation of the maximum amount of the payments under the grant contract. In light of Australia's comments, we revised the sentence in question to reflect Australia's initial explanation in this regard. In addition, Australia asserted that a phrase in paragraph 9.69 of the Panel Report could be misleading. In light of Australia's comments, we revised the phrase in question.

8.3 The United States requested that the Panel reconsider its finding that the loan was not a subsidy that was "contingent ... in fact...upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement. The United States re-emphasized certain factors, including factors based upon confidential business information submitted to the Panel, which, in its view, lead to the conclusion that the loan is "in fact" contingent upon export performance. The Panel did not make any change to its Report in light of the United States comments.

8.4 In its letter of 8 March 1999 transmitting the interim report to the parties, the Panel had indicated that it was "willing to consider brief arguments with respect to the issue of the time period within which the measures found to be prohibited subsidies must be withdrawn under Article 4.7 of the Agreement on Subsidies and Countervailing Measures". Australia made no comments in this regard. The United States endorsed the Panel's recommendation that prohibited subsidies provided to Howe be withdrawn within 90 days.

IX. FINDINGS

9.1 This dispute concerns certain financial assistance provided by the government of Australia to Howe and Company Proprietary Ltd. ("Howe"), the only dedicated producer and exporter of automotive leather in Australia. Automotive leather is primarily used for seat coverings and other interior components of automobiles, such as head and armrests, centre consoles and door trim.

9.2 On 7 October 1996, the United States requested consultations with Australia concerning subsidies available to leather under the Australian Textiles, Clothing and Footwear Import Credit Scheme¹⁷⁵ (the "ICS") and any other subsidies to leather granted or maintained in Australia prohibited under Article 3 of the SCM Agreement.¹⁷⁶ Following consultations, the United States and Australia reached a settlement on 24 November 1996. This settlement was announced on 25 November 1996.¹⁷⁷ Under the terms of settlement, the government of Australia would remove automotive leather from eligibility for benefits under the ICS, as well as under the Export Facilitation Scheme for

¹⁷⁵ The ICS has been in effect from 1 July 1991, and remains in effect through 30 June 2000. Under this programme, exporters of eligible textile, clothing and footwear products can earn import credits that may be used to reduce the import duties payable on eligible textile, clothing and footwear items by an amount up to the value of the credits held. Exporters are not required to use their credits as offsets against import duties, but may transfer them to another holder in exchange for a cash payment. The value of import credits that can be earned is calculated as the F.O.B. value of an eligible export sale, multiplied by the Australian value-added content of the export sale. This total is multiplied by a specified "Export Phasing Rate". TCF Import Credit Scheme: Administrative Arrangements (March 1995), United States Exhibit 7. The ICS is managed by the Australian Customs Service on behalf of the Australian Textiles, Clothing and Footwear Authority.

¹⁷⁶ WT/DS57/1, G/SCM/D7/1, 9 October 1996.

¹⁷⁷ We note that this mutually agreed solution was not notified to the DSB and the relevant Committee, as is required by Article 3.6 of the DSU.

Automotive Products¹⁷⁸ (the "EFS"), by 1 April 1997. On 26 March 1997, Australian Customs Notice No. 97/29 excised automotive leather from the ICS and EFS, effective 1 April 1997.

9.3 At the time of the settlement, the government of Australia announced a commitment to provide financial assistance to Howe, to help maintain its commercial viability in light of the settlement between Australia and the United States, which resulted in the removal of automotive leather from eligibility under the ICS and EFS programmes.¹⁷⁹ The government of Australia entered into two separate agreements, a grant contract and a loan contract, with Howe and its parent company, Australian Leather Holdings, Limited ("ALH") in March 1997.

9.4 The grant contract provides for three payments totalling up to a maximum of A\$30 million, an amount estimated to equal approximately 5 per cent of Howe's expected sales for the period 1 April 1997-31 December 2000. The first payment of A\$5 million was to be paid upon conclusion of the contract. The second and third payments, of up to A\$12.5 million each, were to be paid in July 1997 and 1998 respectively, on the basis of Howe's performance against the targets set out in the contract. The performance targets consist of sales targets and capital expenditure targets. With regard to sales, an overall target for Howe's aggregate sales over the entire term of the contract is established, broken down into interim targets. With respect to capital expenditure, the contract established an aggregate target of A\$22.8 million over the four-year period in question, to be spent on approved investments directly tied to the production of automotive leather, also broken down into interim targets. Howe was required, under the contract, to use "best endeavours" to meet these targets, and to provide the Australian government with reports indicating its sales and capital expenditures.

9.5 The loan contract provides for a fifteen-year loan of \$A25 million by the government of Australia to Howe and its parent company, ALH. For the first five-year period of this loan, Howe/ALH is not required to pay principal or interest. After the expiration of this five-year period, interest on the loan is to be based on the rate for Australian Commonwealth Bonds with a ten-year maturity, plus two percentage points. The loan is secured by a second lien over the assets and undertakings of ALH.

9.6 On 10 November 1997, the United States requested consultations regarding allegedly prohibited subsidies provided to Australian producers and exporters of automotive leather, including subsidies provided to Howe.¹⁸⁰ Consultations held between the United States and Australia on 16 December 1997 failed to resolve the dispute. At its meeting of 22 January 1998, the DSB established a panel in accordance with Article 4.4 of the SCM Agreement and Article 6 of the DSU pursuant to the request made by the United States on 9 January 1998. That panel was never composed.

¹⁷⁸ The EFS has existed in its current form since 1991, and remains in effect until 31 December 2000. The EFS allows Australian manufacturers to earn A\$1 of export credit for every dollar of eligible exports of covered automotive items. The value of exports eligible to earn export credits is equal to the Australian value-added content of eligible exports, calculated as the F.O.B. sales price less the value of any imported components and raw materials. Export credits earned under this programme can be used to obtain rebates on the duties payable on eligible imports of automotive vehicles and automotive components or may be sold for cash to any importer of eligible goods who may similarly seek such rebates. The amount of import duty that can be rebated under this programme is determined by a tariff reduction schedule that varies depending on the year in which the export credit is used. Australian Department of Industry, Science & Technology, Report on the State of the Automotive Industry 1994 (June 1995), United States Exhibit 13.

¹⁷⁹ See Media Release from the Hon. John Moore, MP, Minister for Industry, Science and Tourism, 25 November 1996, United States Exhibit 16. See also United States Exhibit 18. Australia has indicated that automotive leather will be included in new general textile, industry and clothing arrangements due to come into force in Australia on 1 July 2000.

¹⁸⁰ WT/DS106/1, G/SCM/D17/1, 17 November 1997.

9.7 On 4 May 1998, the United States again requested consultations with Australia regarding allegedly prohibited subsidies provided to Howe, alleging that "the [Government of Australia] has provided subsidies to Howe that include a A\$25 million loan, which was made on preferential and non-commercial terms, and grants of up to another A\$30 million. The United States believes that these measures appear to violate the obligations of the [Government of Australia] under Article 3 of the SCM Agreement".¹⁸¹ On 11 June 1998, the United States requested the immediate establishment of a panel, and this Panel was established on 22 June 1998, with standard terms of reference.

A. PRELIMINARY ISSUES AND REQUESTS FOR PRELIMINARY RULINGS

9.8 The United States and Australia each made requests for preliminary rulings in their first submissions. Specifically, the United States asked the Panel to order Australia to produce certain documents. Australia asked the Panel to terminate its work, based on the argument that its establishment was inconsistent with the DSU, or in the alternative, because the United States had failed to meet its disclosure obligations under Article 4 of the SCM Agreement. Assuming the Panel denied the request to terminate, Australia asked the Panel to limit the United States to certain information and arguments in the presentation of its case, based on the argument that the United States failed to meet its disclosure obligations under Article 4 of the SCM Agreement.

9.9 Because these requests involved issues which had important implications for the conduct, indeed, the continuation, of this panel proceeding, we ruled on them at the end of the first meeting with the parties, without detailing our analysis and conclusions.¹⁸² The following sets forth the reasoning underlying our oral rulings of 10 December 1998.

1. Australia's request for termination based on the existence of multiple panels regarding the same matter

9.10 Australia requests that this Panel terminate its work and, in effect, disestablish itself, on the grounds that the DSU does not permit the establishment of a panel when another panel between the same parties with respect to the same matter is in existence.

9.11 Australia's request addresses two different and not necessarily related questions. The first is whether the United States had a right or was entitled under the DSU to unilaterally terminate the first panel, and the second is whether this Panel was properly established. The answer to the first question does not, in our view, control the answer to the second. Even assuming that Australia is correct in

¹⁸¹ WT/DS126/1, G/SCM/D20/1, 8 May 1998.

¹⁸² The Chairperson read the Panel's rulings of 10 December 1998, as follows:

"With respect to the United States request that we ask Australia to produce certain documents, we note that Australia has already submitted redacted versions of the loan and grant contracts. In addition, among the questions from the Panel to the parties are certain requests for information and documents which we have concluded are relevant to our consideration of the issues in this dispute, and therefore have asked Australia to submit.

With respect to Australia's various requests for preliminary rulings, we have carefully considered the arguments of the parties, including the statements made yesterday and the responses to questions put to Australia. We have decided to **deny** Australia's request that we terminate these proceedings. We have also decided to **deny** Australia's request that we order the United States to limit itself to the information set forth in the request for consultations underlying this dispute".

The specific information requested by the Panel, as well as the information provided by Australia in response, are identified in paras. 6.10-6.14 *supra*.

asserting that a panel may not be unilaterally terminated by the complainant after it is established -- an issue we need not and do not decide -- we conclude that this Panel must complete its consideration of the matter referred to it.

9.12 The establishment of a panel is the task of the DSB. It is by no means clear that, once the DSB has established a panel, as it did in this case at its meeting of 22 June 1998, the panel so established has the authority to rule on the propriety of its own establishment. Nothing in our terms of reference expressly authorizes us to consider whether the DSB acted correctly in establishing this Panel. Further, the issues raised by Australia's request are of a systemic nature, concerning questions of policy regarding the operation of the WTO dispute settlement system and an evaluation of the actions taken by the DSB, and thus might be more appropriately taken up in other fora.

9.13 Assuming this Panel does have the authority to rule on the propriety of its own establishment, the DSU does not explicitly address the issue of multiple panels between the same parties regarding the same matter, and thus does not expressly prohibit the establishment of such multiple panels. The DSU does, on the other hand, set forth the conditions and procedures which, if complied with, give the complainant a right to have a panel established. Article 4 governs requests for consultations and Article 6 addresses requests for panel establishment. In a dispute such as this one, concerning allegedly prohibited subsidies, the special or additional procedures in Articles 4.2 through 4.12 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") are also applicable. Article 4.2 of the SCM Agreement deals with requests for consultations and Article 4.4 deals with requests for panel establishment. In order for a panel to be established in respect of a complaint concerning an allegedly prohibited subsidy, a Member must respect the applicable procedures for consultations and panel establishment set out in these provisions of the DSU and the SCM Agreement. If these procedures are followed, the DSU does not impose any further constraints upon the establishment of a panel.

9.14 In our view, Australia is asking this Panel to read into the DSU an implicit prohibition on multiple panels between the same parties regarding the same matter that does not exist in the text of the DSU. Australia's arguments in support of its position arise out of policy considerations and address the object and purpose of the DSU. In light of the fundamental importance in the WTO dispute settlement system of the right to have a panel established to examine a matter, in the absence of a consensus not to do so, we do not consider it appropriate in this dispute to read such an implicit prohibition into the DSU. This is particularly true given that the policy concerns expressed by Australia are purely theoretical and do not arise in this case. Specifically, this is not a case where a complainant is actively pursuing two proceedings with respect to the same matter -- the United States has made it very clear that it is not pursuing the first dispute. To the contrary, the United States has sought to terminate the first dispute, and it is Australia which has sought to prevent that result. Nor is this a case where a complainant has sought a second panel before a first panel has completed its work with respect to the same matter because it was dissatisfied with developments in the first panel. Although the first panel in this case was established, it was never composed and thus never began its work.

9.15 For the foregoing reasons, we deny Australia's request to terminate this Panel, and will continue our work in accordance with our terms of reference.

2. Compliance with Article 4.2 of the SCM Agreement

9.16 Australia also asks us to terminate this Panel, or in the alternative, to disregard during the course of this proceeding all facts and arguments not explicitly set out in the request for consultations (WT/DS126/1), based on its assertion that the United States request for consultations does not comply with the requirements of Article 4.2 of the SCM Agreement.

9.17 Article 4.2 of the SCM Agreement provides:

"A request for consultations under paragraph 1 [of Article 4] shall include a statement of available evidence with regard to the existence and nature of the subsidy in question".

Focusing on the term "available evidence" in Article 4.2, Australia argues that the *quid pro quo* for the accelerated dispute settlement procedure available under Article 4 of the SCM Agreement is that the complainant must "show its hand" at the outset of the proceedings in order to guarantee that information necessary for the respondent to defend itself is provided. In Australia's view, Article 4.2 imposes an obligation on the complainant to disclose, in its request for consultations, not only facts, but also the argumentation why such facts lead the complainant to believe there is a violation of Article 3.1.

9.18 The ordinary meaning of the phrase "include a statement of available evidence" does not, on its face, require disclosure of arguments in the request for consultations. Nothing in the context or object and purpose of Article 4.2, discussed below, suggests a different conclusion.

9.19 Turning to the question of what is required as a "statement of available evidence", we note that Australia reads this to require disclosure of **all** facts and evidence on which the complaining Member will rely in the course of the dispute. Indeed, Australia asserts that any exhibits should have been provided at the time consultations were requested.¹⁸³ The ordinary meaning of the phrase "statement of available evidence" does not support Australia's position. The word "evidence" is defined as "available facts, circumstances, etc., supporting or otherwise a belief, proposition, etc."¹⁸⁴ "Available" is defined as "at one's disposal", and "statement" is defined as "expression in words".¹⁸⁵ Thus, based on the ordinary meaning of the terms, Article 4.2 requires a complaining Member to include in the request for consultations an expression in words of the facts at its disposal at the time it requests consultations in support of the conclusion that it has, in the words of Article 4.1, "reason to believe that a prohibited subsidy is being granted or maintained". This is, in our view, considerably less than Australia would have Article 4.2 require.

9.20 Moreover, nothing in the context or object and purpose of Article 4.2 suggests to us that the statement of available evidence must be as comprehensive as Australia would require. The mere fact that proceedings under Article 4 of the SCM Agreement are accelerated by comparison to dispute settlement proceedings under the DSU does not, in our view, require us to read into Article 4.2 a requirement that the complainant disclose all facts and arguments in its request for consultations. In dispute settlement proceedings conducted pursuant to a normal schedule, a complaining Member is not even required to include a statement of the facts and arguments in a request for establishment of a panel – which comes considerably later in the dispute settlement process, after a consultation request has been made and after the parties have consulted. The complaining party is required only to identify the claims concerning the matter at issue; the facts and arguments on which it relies to establish its case must be submitted only in the first and subsequent submissions of the party to a

¹⁸³ Australia's first submission at para. 41, *supra*, para. 6.51.

¹⁸⁴ *Concise Oxford Dictionary*, ninth ed., 1995.

¹⁸⁵ *Id.*

panel.¹⁸⁶ To the extent that the additional requirement of Article 4.2 can be linked to the expedited nature of the proceedings, the additional requirement of a statement of available evidence satisfies the need adequately to apprise the responding Member of the information upon which the complaining Member bases its request for consultations, and serves in addition to inform the resulting consultations.

9.21 Looking at the United States request for consultations, we note that the statement of available evidence sets forth both the nature of the evidence at the United States' disposal being relied upon, and summarizes the facts the United States derived from that evidence which support a reason to believe Australia was granting or maintaining a prohibited subsidy.¹⁸⁷ This statement of available evidence was adequate to apprise Australia of the information on which the United States was basing its request for consultations and to inform the resulting consultations. Accordingly, we conclude that the United States request for consultations in this case is in compliance with the requirements of Article 4.2 in that it contains a sufficient statement of available evidence.

9.22 Based on the foregoing, we deny Australia's request to terminate this proceeding¹⁸⁸, and we further deny Australia's request that we disregard any facts and arguments not explicitly set out in the request for consultations.

3. Limitation on evidence and arguments

9.23 Australia also appears to be asking us to rule that, even assuming the United States statement of available evidence complied with the requirements of Article 4.2, the United States is limited to relying on the facts and arguments explicitly set out in its request for consultations in presenting its case to the Panel.

9.24 Australia reads the requirement of Article 4.2, that a request for consultations "include a statement of available evidence", in conjunction with the expedited nature of the proceedings, as requiring a panel to limit the complaining Member to using the evidence and arguments set forth in the request for consultations, and asserts that to allow a complainant to come forward with additional facts and arguments in its first submission is inconsistent with Article 4 of the SCM Agreement.¹⁸⁹

9.25 A panel is obligated by Article 11 of the DSU to conduct "an objective assessment of the matter before it". Any evidentiary rulings we make must, therefore, be consistent with this obligation. In our view, a decision to limit the facts and arguments that the United States may present during the course of this proceeding to those set forth in the request for consultations would make it difficult, if not impossible, for us to fulfill our obligation to conduct an "objective assessment" of the matter before us.

¹⁸⁶ In *European Communities – Bananas*, WT/DS27/AB/R, adopted 25 September 1997, para. 141, the Appellate Body stated:

... there is a significant difference between the *claims* identified in the request for the establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the *arguments* supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties.

¹⁸⁷ See WT/DS126/1, excerpted *supra*, para. 6.58.

¹⁸⁸ We note that, having determined that the United States statement of available evidence is adequate, we need not and do not reach any conclusions as to what action would be appropriate if that statement were not adequate.

¹⁸⁹ Australia's first submission at para. 42, *supra*, para. 6.52.

9.26 As discussed above, Article 4.2 does not require a complaining Member to disclose arguments in the request for consultations. Thus, there is no basis for limiting the scope of arguments in this proceeding.

9.27 Article 4.2 does contain a requirement, not present in the DSU, that a complainant include a "statement of available evidence" in its request for consultations. However, we do not consider that the scope of the evidence that a panel may consider is limited in any way by such a statement of available evidence. In this respect, we note Article 4.3 of the SCM Agreement, which explicitly states that one of the purposes of consultations "shall be to *clarify the facts of the situation...*". (emphasis added) This provision implies that additional facts or evidence will be developed during consultations. Moreover, the Appellate Body has recognized that consultations play a significant role in developing the facts in a dispute settlement proceeding. For example, in *India - Patents*¹⁹⁰, the Appellate Body observed that "the claims that are made *and the facts that are established during consultations* do much to shape the substance and the scope of subsequent panel proceedings". (emphasis added) This is consistent with the view that a central purpose of consultations in general, and of consultations under Article 4 of the SCM Agreement in particular, is to clarify and develop the facts of the situation.

9.28 Moreover, we note that panels have, under Article 13.2 of the DSU, a general right to seek information "from any relevant source". Indeed, it is a common feature of panel proceedings for panelists to question parties about the facts and arguments underlying their positions. There is nothing in Article 4 of the SCM Agreement to suggest that this right is somehow limited by the expedited nature of dispute settlement proceedings conducted under that provision. If Australia's position were correct, a panel might be constrained from seeking out relevant information from the party, in this case the United States, that was limited to reliance on the facts set forth in its request for consultations. Similarly, under Australia's view, the defending party might introduce information during the panel proceedings, which the complaining party, in this case the United States, would not be able to rebut, as it would be limited to reliance on the facts set forth in its request for consultations. We do not believe Article 4.2 requires this result.

9.29 Finally, as noted above, in the usual case, a complaining Member is not even required to include its facts and arguments in a request for establishment of a panel – which comes considerably later in the dispute settlement process than the consultation request. This implies that the scope of the facts and evidence that may be considered in a dispute settlement proceeding should not be limited to those set out in the request for consultations, merely because a proceeding under Article 4 of the SCM Agreement is conducted on an accelerated time schedule. Article 4.2 does require a complaining Member to include more information about its case in its request for consultations than is otherwise required under the DSU. This serves to provide a responding Member with a better understanding of the matter in dispute, and serves as the basis for consultations. Specifically, the statement of available evidence informs the responding Member of the facts at the disposal of the complaining Member at the time it requests consultations that support the complaining Member's conclusion that it has "reason to believe" that a prohibited subsidy is being granted or maintained by the responding Member. The statement of available evidence thus informs the beginning of the dispute settlement process – it does not limit the scope of evidence and argument for the entire proceeding that may ensue to only what is in the request for consultations.

¹⁹⁰ Appellate Body Report, *India – Patents*, WT/DS50/AB/R, adopted 16 January 1998, para. 94.

9.30 We therefore deny Australia's request that we limit the evidence and arguments on which the United States may rely in this proceeding to those set forth in the request for consultations, WT/DS126/1.¹⁹¹

4. Information acquired in the context of consultations held pursuant to the first request (WT/DS106/1) and Exhibit 2 to the United States first submission

9.31 Australia also requests that we rule that information acquired in the context of consultations held pursuant to the first request by the United States, in document WT/DS106/1, including Exhibit 2 to the United States first submission, is not admissible before this Panel. Australia argues that those consultations, and any facts derived by the United States from those consultations, including Exhibit 2, and arguments based on those facts, are confidential to that panel process, and should therefore not be permitted in this panel process without Australia's agreement.

9.32 As Australia rightly notes, Article 4.6 of the DSU provides that "Consultations shall be confidential, and without prejudice to the rights of any Member in any further proceedings". However, in our view, this does not mean that facts and information developed in the course of consultations held pursuant to one request cannot be used in a panel proceeding concerning, as it does in this case, the same dispute, between the same parties, conducted pursuant to another, different request.

9.33 We recall that Article 11 of the DSU obliges a panel to conduct "an objective assessment of the matter before it". As discussed earlier, any evidentiary rulings we make must be consistent with this obligation. The panel in *Korea – Taxes on Alcoholic Beverages* recently confirmed the right of a party to a WTO dispute to use information learned in consultations in panel proceedings. After noting the requirement of confidentiality in Article 4.6 of the DSU, which the panel viewed as "essential if the parties are to be free to engage in meaningful consultations", the panel continued:

"However, it is our view that this confidentiality extends only as far as requiring the parties to the consultations not to disclose any information obtained in the consultations to any parties that were not involved in those consultations. We are mindful of the fact that the panel proceedings between the parties remain confidential, and parties do not thereby breach any confidentiality by disclosing in those proceedings information acquired during the consultations. Indeed, in our view, the very essence of consultations is to enable the parties [to] gather correct and relevant information, for purposes of assisting them in arriving at a mutually agreed solution, or failing which, to assist them in presenting accurate information to the panel. It would seriously hamper the dispute settlement process if the information acquired during consultations could not be subsequently used by any party in the ensuing proceedings".¹⁹²

9.34 Given that, in this case, the parties and the dispute are the same, no panel was actually composed or considered the dispute in the first-requested proceeding, and there are no third parties involved in either proceeding who might have learned information in the course of consultations, we cannot see any reason to exclude the United States Exhibit 2 from our consideration, merely because

¹⁹¹ In this regard we note that, as a matter of fact, almost all of the evidence presented by the United States as exhibits to its first submission falls within the scope of what is described in the request for consultations.

¹⁹² WT/DS75/R, WT/DS84/R, WT/DS75/AB/R, WT/DS84/AB/R, adopted 17 February 1999, para. 10.23. The referenced aspect of the Panel's ruling was not at issue before the Appellate Body.

it was developed in the course of the consultations held pursuant to the first request.¹⁹³ Australia has failed to specify what other, if any, facts might have been derived by the United States from the earlier consultations, and so there is no basis for us to exclude any such facts.

9.35 We therefore deny Australia's request that we rule that information acquired in the context of consultations held pursuant to the first request by the United States, in document WT/DS106/1, including Exhibit 2 to the United States first submission, is not admissible before this Panel.

B. ARE THE MEASURES BEFORE THE PANEL EXPORT SUBSIDIES WITHIN THE MEANING OF ARTICLE 3.1(A) OF THE SCM AGREEMENT?

1. What are the measures before the Panel?

9.36 Australia argues that the measures before us are the A\$25 million preferential loan to Howe and the first two payments made to Howe pursuant to the grant contract. Thus, in Australia's view, neither the third payment to Howe, made in June 1998, nor the grant contract itself are "measures" encompassed by the request for establishment, and are consequently not before us. The United States, on the other hand, asserts that its request for establishment in this dispute explicitly identifies the measures before the Panel as being the loan contract and the grant contract, including any and all possible disbursements under the latter contract. In the alternative, citing *Japan – Film*¹⁹⁴, the United States asserts that if the Panel were to conclude that either the grant contract or the third payment thereunder was not explicitly described in the request for establishment, these were clearly included in the request for establishment, as subsidiary or closely related to the specifically identified measures.

9.37 Australia attempts to draw a distinction, in particular, between the grant contract and the three payments made thereunder.¹⁹⁵ The issue is significant because the final payment under the grant contract was not made until after the Panel was established, and thus, in Australia's view, falls outside the Panel's terms of reference and cannot be considered by the Panel. Australia maintains that the Panel will have to consider the consistency with the SCM Agreement of each of the grant payments, and of the loan, separately, and could find that one or more were consistent, and the other(s) were not.

9.38 In our view, the distinction that Australia invites us to draw between the grant contract and the grant payments is artificial as regards the determination of what measures are before the Panel. The document setting out the "matter" before the Panel, and therefore governing the Panel's terms of reference, is the United States' request for establishment of a panel. In this document, the United States states:

"The Government of Australia has provided subsidies [to Howe]. The United States understands that these subsidies include the provision by the Government of Australia

¹⁹³ There is nothing to indicate that there would have been any different answers had the same questions been asked by the United States during consultations held pursuant to the second request. We note Australia's view that there were no consultations held pursuant to the second request, although there was a meeting between the parties. Presumably, this view is based on Australia's position that the second request for consultations, and the second request for establishment, like this Panel which flowed from those requests, were inconsistent with the DSU.

¹⁹⁴ WT/DS44/R, adopted 22 April 1998.

¹⁹⁵ Australia makes no distinction between the loan contract and the disbursement of the loan funds, and thus seems to accept that loan contract is a "measure" that is before the Panel. See Australia's first submission at para. 58 ("the 'loan' [referred to in the United States' panel request] is clearly the loan provided under the Loan contract"). *Supra*, para. 7.3.

to Howe of grants worth as much as A\$30 million and a A\$25 million loan on preferential and non-commercial terms".¹⁹⁶

9.39 The ordinary meaning of the term "provision" is "the act or an instance of providing".¹⁹⁷ The act or instance of providing the grant payments in this case was the grant contract, which established the conditions for the disbursement of the grant funds. Thus, the language of the request for establishment specifically includes the grant contract. Moreover, the ordinary meaning of the term "grant" means "the process of granting or a thing granted",¹⁹⁸ and therefore includes both the government's commitment to make payments (that is, the grant contract), and the grant payments themselves, including all possible disbursements, whether past or future.

9.40 Thus, we conclude that the specific words of the request for establishment, which sets the terms of reference for this panel, cover the loan contract (which encompasses the single disbursement of the loan funds), the grant contract, and the individual payments made under the latter contract.¹⁹⁹

9.41 Apart from the specific language used in the panel request itself, other considerations also support our conclusion that the measures before the Panel are not limited to the specific payments made under the grant contract prior to the request for establishment of this Panel, but include the contract itself and any payments thereunder. The grant contract is the specific legal instrument that lays out the terms and conditions for the individual payments to be made thereunder, and which therefore governs and defines the nature of those payments. The grant contract commits the government of Australia to make certain payments to Howe, provided the conditions established in the contract are satisfied. In our view, we have before us all the necessary information to rule on all the payments provided for in the grant contract.

9.42 Based on the foregoing, we do not consider it necessary to draw the distinction that Australia proposes between the grant contract and the grant payments for the purpose of defining the measures that are before the Panel, and conclude that the measures before us are the loan contract, the grant contract and the individual payments under the latter contract.

2. Are the measures before the panel "subsidies" within the meaning of Article 1 of the SCM Agreement?

9.43 The parties are in agreement that the loan is a subsidy within the meaning of Article 1 of the SCM Agreement. The parties are also in agreement that each of the three payments under the grant contract is also a subsidy within the meaning of Article 1 of the SCM Agreement. However, the parties are not in agreement whether the grant contract itself is a subsidy within the meaning of Article 1 of the SCM Agreement. Therefore, we turn now to that question.

9.44 The United States argues that the grant contract is a "financial contribution" that confers a "benefit" and is, therefore, a subsidy under Article 1 of the SCM Agreement. The United States asserts that Howe has been given a benefit in the form of government funds that it need not repay. Australia, on the other hand, asserts that the United States has not demonstrated that the grant contract is a subsidy, although, as noted above, it acknowledges that the payments authorized by that contract are subsidies, *i.e.* "financial contributions" that confer a "benefit".

¹⁹⁶ WT/DS126/2, 11 June 1998.

¹⁹⁷ *Concise Oxford Dictionary*, ninth ed., 1995.

¹⁹⁸ *Concise Oxford Dictionary*, ninth ed., 1995.

¹⁹⁹ In light of our decision, we did not consider, and draw no conclusions regarding, the United States argument regarding subsidiary or closely related measures.

9.45 This issue is closely linked to our discussion above concerning what are the "measures" that are before the Panel. Australia does not dispute that the grant payments are, themselves, subsidies. The terms and conditions for the disbursement of the payments are provided for in the grant contract. In our view, each payment can be evaluated individually to determine whether it is a prohibited export subsidy, but only by reference to the criteria for disbursement set out in the grant contract. Thus, we need not decide whether or not the grant contract is a subsidy in order to evaluate the individual payments. We have determined above that, based on the specific language of the request for establishment, the grant contract is a measure that is before us in this case. The evaluation of the consistency of challenged elements of the grant contract must take into account what actually occurs, particularly in a case where the allegation is that the subsidies are contingent in fact on export performance. Therefore, we need not determine whether the grant contract is itself a subsidy in order to determine whether the payments made pursuant to that contract, which Australia acknowledges are subsidies, are prohibited export subsidies.

3. Are the subsidies in question "contingent, in law or in fact" on export performance, within the meaning of Article 3.1(a) of the SCM Agreement?

9.46 Article 3.1 of the SCM Agreement provides:

"3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact⁴ whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I^[...];

⁴This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision".

Article 3.2 of the SCM Agreement reinforces this prohibition, providing:

"3.2 A Member shall neither grant nor maintain subsidies referred to in paragraph 1".

- (a) contingent in law

9.47 The United States argued, in its first written submission to the Panel, that, because Howe was granted the new aid package as a specific replacement for the *de jure* subsidies of the ICS and EFS export schemes, the new subsidies are also *de jure* export subsidies. However, the United States did not pursue this line of argument in subsequent submissions, after it had received copies of the grant and loan contracts. Australia asserts that the United States put forward no evidence that any of the measures is contingent "in law" upon export performance, and moreover that this issue is not properly before the Panel as there is no claim regarding the question of "contingent in law" in the request for establishment.

9.48 In our view, the Panel's terms of reference include the issue of whether the subsidies in question are contingent "in law" on export performance. The United States panel request cites both the "in law" and "in fact" aspects of Article 3.1(a) of the SCM Agreement, and the United States claim is that the subsidies are inconsistent with Article 3.1(a). How those subsidies are inconsistent,

whether because they are contingent in law or in fact upon export performance, is an aspect of the arguments put forward by the United States in support of its claim.

9.49 However, as the United States has not pressed its arguments in this regard, we consider that it has abandoned them. We therefore do not reach any conclusions on this issue, and, turn now to the question whether the subsidies in question are contingent in fact upon export performance.

(b) contingent in fact

9.50 The United States argues that the measures are subsidies contingent in fact on Howe's export performance, as they are tied to actual or anticipated exportation or export earnings. The United States favours a broad approach to the "contingent ... in fact" standard in Article 3.1(a), and emphasizes that this standard must be approached on a case-by-case basis, taking into account the structure and design of the measure at stake and the specific facts involved. In the United States view, the distinction between the "in law" and "in fact" standard is that "in law" subsidies are explicitly contingent, and "in fact" subsidies are implicitly contingent, upon export performance. Moreover, footnote 4 of the SCM Agreement does not preclude consideration of the fact of exportation or the level of exports; it simply proscribes finding a prohibited export subsidy based *solely* upon the level of exports. In fact, the explicit reference to level of exports in Article 3, in the United States view, indicates that the drafters specifically contemplated that the level of exports would be taken into account in determining whether a "contingent in fact" export subsidy exists. The United States argues that a contingent-in-fact export subsidy will exist when actual or anticipated exportation is merely one of several potential criteria influencing the bestowal of benefits. Thus, if the totality of the circumstances reveal that these benefits are designed to promote exports, then such benefits fall within the broad definition of Article 3.1(a). The United States urges us to look to the assumptions underlying the government's decision to grant the subsidy in order to determine whether the "in fact" standard has been met.

9.51 Australia favours a narrow approach to the "contingent ... in fact" test in Article 3.1(a).²⁰⁰ In Australia's view, the contingent in fact standard is defined and limited by footnote 4 of the SCM Agreement. The distinction between "contingent in law" and "contingent in fact" is intended to distinguish between the situation where something is set out explicitly in legislation or regulation ("in law") and where there is some non-legislative, administrative arrangement whereby the granting of the subsidy is actually tied to export performance ("in fact"). The purpose of the "in fact" provision is to provide a way of dealing with the situation where the administration of a subsidy programme allows the disbursement of funds to favour exports, *i.e.* to provide subsidies to firms tied to export performance. Australia urges us to reject a test based on some "undefined level of exports" for determining whether a subsidy is a prohibited export subsidy. The facts must demonstrate that the granting of the subsidy is in fact tied to actual or anticipated exportation or export earnings. In other words, "the complainant must show that the granting of the subsidy is in fact tied in its application to export performance and so favours export over domestic sales".²⁰¹ In this regard, Australia argues that WTO rules need to provide clear guidance to Members, and the United States position would leave Member unable to plan domestic support policies in a way that would avoid running afoul of the prohibitions of Article 3.1(a).

²⁰⁰ Referring to the United States references to "*de jure*" and "*de facto*" prohibited subsidies, Australia asserts that the United States arguments are misdirected, contending that the SCM Agreement does not refer to "*de jure*" and "*de facto*" export subsidies, but to contingent "in law" and contingent "in fact" export subsidies. In our view, the United States uses the phrase "*de facto*" interchangeably with the phrase "in fact". We thus conclude that the United States arguments clearly relate to the prohibition set forth in Article 3.1(a), regardless of the occasional use of the phrase *de facto*.

²⁰¹ Australia's first submission, para. 101, *supra*, para.7.103.

9.52 The United States asserts that a subsidy must be found to be "in fact" contingent when actual or anticipated exportation is merely one of several criteria influencing the bestowal of benefits.²⁰² Thus, the United States asserts that if the totality of the circumstances reveals that the subsidy in question is designed to promote exports, then that subsidy comes within the ambit of Article 3.1(a), and is prohibited.²⁰³ Australia argues, on the other hand, that in order to demonstrate that the granting of the subsidy is in fact tied in its application to export performance, it must be determined that the grant (or maintenance) of the subsidy favours export over domestic sales.²⁰⁴

9.53 The essential difference between the parties relates to the nature and scope of the relationship or connection that must exist between a subsidy and export performance in order for the subsidy to be "in fact" contingent upon export performance and, thus, a prohibited export subsidy within the meaning of Article 3.1(a) of the SCM Agreement. The resolution of this issue hinges upon the interpretation and application of the term "contingent ... in fact ... upon export performance" in Article 3.1(a) of the SCM Agreement.

9.54 Pursuant to Article 3.2 of the DSU, we must interpret Article 3.1(a) of the SCM Agreement "in accordance with customary rules of interpretation of public international law". According to established WTO practice, these rules are found in Article 31 of the *Vienna Convention*. Paragraph 1 of this Article states:

"A treaty shall be interpreted in good faith and 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".

9.55 An inquiry into the meaning of the term "contingent ... in fact" in Article 3.1(a) of the SCM Agreement must, therefore, begin with an examination of the ordinary meaning of the word "contingent". The ordinary meaning of "contingent" is "dependent for its existence on something else", "conditional; dependent on, upon".²⁰⁵ The text of Article 3.1(a) also includes footnote 4, which states that the standard of "in fact" contingency is met if the facts demonstrate that the subsidy is "in fact tied to actual or anticipated exportation or export earnings". The ordinary meaning of "tied to" is "restrain or constrain to or from an action; limit or restrict as to behaviour, location, conditions, etc.".²⁰⁶ Both of the terms used -- "contingent ... in fact" and "in fact tied to" -- suggest an interpretation that requires a close connection between the grant or maintenance of a subsidy and export performance.

9.56 In our view, the concept of "contingent ... in fact ... upon export performance", and the language of footnote 4 of the SCM Agreement, require us to examine all of the facts that actually surround the granting or maintenance of the subsidy in question, including the terms and structure of the subsidy, and the circumstances under which it was granted or maintained. A determination whether a subsidy is in fact contingent upon export performance cannot, in our view, be limited to an examination of the terms of the legal instruments or the administrative arrangements providing for the granting or maintenance of the subsidy in question. Such a determination would leave wide open the possibility of evasion of the prohibition of Article 3.1(a), and render meaningless the distinction between "in fact" and "in law" contingency. Moreover, while the second sentence of footnote 4 makes clear that the mere fact that a subsidy is granted to enterprises which export cannot be the sole basis for concluding that a subsidy is "in fact" contingent upon export performance, it does not preclude the consideration of that fact in a panel's analysis. Nor does it preclude consideration of the

²⁰² United States first submission, para. 37, *supra*, para. 7.82

²⁰³ United States first submission, para. 38, *supra*, para. 7.82.

²⁰⁴ Australia's first submission, para. 101, *supra*, para. 7.103.

²⁰⁵ *The New Shorter Oxford English Dictionary*, Vol. 1, 1993.

²⁰⁶ *Ibid.*

level of a particular company's exports. This suggests to us that factors other than the specific legal or administrative arrangements governing the granting or maintenance of the subsidy in question must be considered in determining whether a subsidy is "in fact" contingent upon export performance.

9.57 Based on the explicit language of Article 3.1(a) and footnote 4 of the SCM Agreement, in our view the determination of whether a subsidy is "contingent ... in fact" upon export performance requires us to examine all the facts concerning the grant or maintenance of the challenged subsidy, including the nature of the subsidy, its structure and operation, and the circumstances in which it was provided. In this context, Article 11 of the DSU requires a panel to make an objective assessment of the facts of the case. Obviously, the facts to be considered will depend on the specific circumstances of the subsidy in question, and will vary from case to case. In our view, all facts surrounding the grant and/or maintenance of the subsidy in question may be taken into consideration in the analysis. However, taken together, the facts considered must demonstrate that the grant or maintenance of the subsidy is conditioned upon actual or anticipated exportation or export earnings. The outcome of this analysis will obviously turn on the specific facts relating to each subsidy examined.

(c) analysis of the facts

9.58 The United States asserts that the status of the loan contract, the grant contract, and the grant payments is inextricably linked, and that the factual circumstances demonstrate that each of them is a subsidy contingent in fact upon export performance. In the United States view, the following facts demonstrate that the subsidies in question are prohibited export subsidies: the Australian government was aware that Howe was exporting 90 per cent of its sales at the time the government of Australia entered into the grant and loan contracts; the replacement package was specifically and explicitly designed to compensate Howe for its exclusion from two "in law" export subsidy programmes (the ICS and EFS programmes) that had helped transform Howe into a major exporter; the recognized purpose of the replacement package by both the Australian government and Howe was export promotion; Howe had aggressive export plans; Howe must significantly increase its sales to receive the full A\$30 million grant for which it is eligible; however, the Australian leather market is too small to absorb Howe's current -- much less, its increased -- production; the only way that Howe could increase its sales and utilise the expanded production capacity that it has acquired as a result of the subsidies in question is to significantly increase its exports; and the subsidies in question were provided only to Howe, which exports virtually all of its production, and not to any leather manufacturer that supplies the domestic market.

9.59 Australia emphasizes that the measures before the Panel are individual measures, and each must be individually considered in determining whether it is consistent with the requirements of the SCM Agreement. With regard to the facts relied on by the United States, Australia asserts that the nature of prior measures (the ICS and EFS programmes) is not relevant and, in any case, these measures are outside the Panel's terms of reference; an assessment of the imputed objectives of governments is not the basis on which a rules-based system such as the WTO is supposed to operate; and the structure of the loan and the grant demonstrate that they are not linked in any way to Howe's export performance. With respect to the loan, Australia argues that the level of Howe's production and sales is irrelevant so long as the company pays the Government any monies owing. Precisely how Howe and ALH finally repay the loan is a matter solely for the borrowers themselves. The loan contract determines the interest rate payable and the schedule for repayments of principal. It does not prescribe how Howe and ALH will fund the repayments or from where it will source these funds. Australia notes that the ability of Howe/ALH to repay does not rely solely on the domestic or export markets for automotive leather. These are currently important elements of Howe/ALH's operations, but it is impossible to say what the markets or the product mix will be when the major repayments are due.

9.60 With respect to the grant payments, Australia argues that only the first two payments made under the grant contract are before the Panel. Because these monies are not recoverable regardless of the actual level of sales by Howe, they cannot be considered to be in fact tied to exports. In Australia's view, they are not linked to future exports, let alone satisfying what it considers the stringent requirements for the "in fact" condition in Article 3.1(a). Australia asserts that, in any event, the first payment of A\$5 million was an automatic payment made following the signing of the grant contract, and was not tied to anything, let alone export performance. The second payment of A\$12.5 million was made on the basis that the company had satisfied its investment and sales targets on a best endeavours basis, as well as normal due diligence considerations. There is no way in which the company could have obtained more money regardless of how much it invested or sold. Assuming the Panel considers the third grant payment, Australia asserts that it was made on the basis of an assessment that the company had performed satisfactorily on a best endeavours basis in respect of a combination of investment and production in 1997/98, as well as normal due diligence considerations. Again, Australia states that the government cannot take back that money, provided that Howe continues in business. The company could expand or reduce sales and the status of the payments under the grant contract would be unchanged. The money is gone and there is no connection with future sales, including sales for export.

9.61 We agree with Australia that we must consider the challenged measures individually to determine their consistency with the SCM Agreement. Merely because all the challenged subsidies form part of a single "package" of assistance to Howe does not mean that all of them are perforce either prohibited export subsidies or not. In this regard, we note that, in our view, it is perfectly possible for a Member to construct a package of subsidies to aid domestic industry, of which some are consistent with the SCM Agreement, and others are not. It is, therefore, necessary that each subsidy be evaluated on its own terms in deciding whether it is consistent with the SCM Agreement.

(i) *the payments under the grant contract*

9.62 The grant contract provides for three subsidy payments up to a maximum of A\$30 million. The contract is between the government of Australia and Howe and its parent company, ALH. However, the terms of the grant contract are specifically directed at Howe, and more particularly at Howe's automotive leather operations. The contract provides for an aggregate sales performance target for the period 1 April 1997 – 31 December 2000, broken down into four interim sales targets.²⁰⁷ The contract provides for the funds to be disbursed in three payments during the first two years of the contract term.²⁰⁸ The first payment of A\$5 million was made upon the signing of the contract between Howe/ALH and the Australian government. The second and third payments of up to A\$12.5 million each were to be made on specific dates in 1997 and 1998 upon receipt of a report from Howe showing performance against the sales performance and investment targets for the years ending 30 June 1997 and 30 June 1998, respectively, satisfactory to the Department of Industry, Science and Tourism. Howe is obliged by the contract to use its "best endeavours" to satisfy the performance targets set forth in the contract.

9.63 Australia has acknowledged that it is unlikely that the grant contract would have been entered into in a circumstance other than the removal of automotive leather from the EFS and ICS programmes. In this regard, we note Australia's argument that it is "simplistic" to conclude that this was the sole reason for providing the challenged assistance to Howe, pointing to, *inter alia*, the government's concern for job retention in the region in the absence of support for the company.

²⁰⁷ Howe is obligated to submit reports of its performance against the interim performance targets for each of the periods ending 30 June 1997, 1998, 1999 and 2000, as well as final report in September 2000.

²⁰⁸ With the exception of a small portion of the third payment held back pending final assessment that Howe has satisfied the requirements of the contract, the maximum amount provided for in the grant contract, A\$30 million, has already been paid to Howe.

However, we recall that Article 3.1(a) recognizes that there may be multiple conditions for the grant or maintenance of a subsidy, and explicitly prohibits a subsidy if one of the conditions is that the subsidy is contingent in fact upon export performance. In taking into consideration the fact that the government of Australia was providing assistance to Howe directly following the removal of automotive leather from eligibility for benefits under the EFS and ICS programmes, we do not make any legal conclusions about those programmes. The ICS and EFS themselves are not measures that fall within our terms of reference, and we need not draw any conclusions about whether they are prohibited export subsidies under the provisions of Article 3 of the SCM Agreement.

9.64 Australia argues that the nature of the ICS and EFS programmes cannot be considered in analysing the consistency with the SCM Agreement of the challenged subsidies, including the grant payments, asserting that it must be possible for a government to provide subsidies to domestic firms without such assistance being automatically deemed a prohibited export subsidy even assuming the programme those firms previously benefitted from was a prohibited subsidy. WTO Members cannot be prevented from replacing purported prohibited export subsidies with other measures that are not prohibited, thereby bringing themselves into compliance with their multilateral obligations under the SCM Agreement. We agree that, even assuming the ICS and EFS were prohibited export subsidies (a question on which we draw no conclusions), this would not, *ipso facto*, mean that any subsequent subsidy granted to a company that had previously benefitted from those programmes would be a prohibited export subsidy.

9.65 Nevertheless, in this case, based upon evidence concerning those programmes submitted by the United States, the facts of which are undisputed by Australia, we observe that both the ICS and EFS programmes give incentives to Australian companies to export certain products. Howe earned significant benefits from its exports of automotive leather pursuant to those programmes. Automotive leather was removed from eligibility under those programmes, and the government of Australia entered into the loan contract and the grant contract providing financial assistance at least in part to tide Howe over after it had lost eligibility for benefits related to automotive leather under these programmes.²⁰⁹ Public reports at the time indicated that the amount of the assistance provided for was that deemed necessary to ensure that Howe continued in business.²¹⁰

²⁰⁹ Australia has stated that automotive leather will be among the products eligible under the new programme it is developing to replace the ICS and EFS programmes, anticipated to be put into effect in 2000.

²¹⁰ In this regard, we note that Australia argues that the statements of government officials reported in the press cannot be considered evidence of the intent of the Australian government in providing assistance to Howe. We are not drawing any specific conclusions concerning the intent of the Australian government – we recognize that there may have been a number of purposes, a variety of "intent", involved in the decision to assist Howe subsequent to the removal of automotive leather from eligibility under the ICS and EFS programmes. Nonetheless, we consider the reports, both press and company, submitted by the United States as relevant to our analysis of the facts and circumstances surrounding the design and grant of that assistance. Moreover, to the extent that Australia has not specifically challenged the truth of the facts (or statements by individuals) reported, we conclude that we may consider these articles, and make our own judgment as to their appropriate weight and probative value. A commentator on the International Court of Justice's consideration of evidence and proof of facts has stated:

"It appears to be the case that press reports, when significant but not denied by the responsible state, or when reporting other events such as official statements by responsible officials and agencies of that state, are accepted; [footnote omitted] but when they are uncorroborated or do not otherwise contain material with an independent title of credibility and persuasiveness, the tendency of the Court is to discount them almost entirely".

Hight, *Evidence and Proof of Facts*, in Damrosch, The International Court of Justice at a Crossroads, 1987. Similarly, we take into account the circumstances in which the reported remarks were made, the source, and

9.66 At the time the grant contract was concluded, Howe exported a significant portion of its production, and the Australian government was aware of this. The parties dispute the level of Howe's exports in relation to domestic sales. However, it is undisputed that Howe's exports had increased significantly during the period it benefitted from the ICS and EFS programmes, and that at the time automotive leather was removed from eligibility under those programmes, the overwhelming majority of Howe's sales were for export. The government of Australia was concerned that Howe remain in business, and determined to give it a financial assistance package in order to ensure that it did so.²¹¹ In these circumstances, it is clear to us that continued exports, that is, anticipated exportation, was an important condition in the provision of that assistance. We note, as discussed above, that footnote 4 of the SCM Agreement does not preclude consideration of the fact that a company exports, or of the level of its exports, in a prohibited subsidy examination. Rather, it merely proscribes finding a prohibited export subsidy based *solely* upon the fact that a subsidy is granted to a company which exports. While the fact of exportation cannot be the sole determinative fact in the evaluation, in our view, it is clearly a relevant factor in this case, as is the level of exports.

9.67 Moreover, it is clear that the Australian market for automotive leather is too small to absorb Howe's production, much less any expanded production that might result from the financial benefits accruing from the grant payments, and the required capital investments, which were to be specifically for automotive leather operations.²¹² Therefore, we conclude that, in order to expand its sales in a manner that would enable it to reach the sales performance targets (interim targets and the aggregate target) set out in the grant contract, Howe would, of necessity, have to continue and probably increase exports. At the time the contract was entered into, the government of Australia was aware of this necessity, and thus anticipated continued and possibly increased exports by Howe. In our view, these facts effectively transform the sales performance targets into export performance targets. We thus consider that Howe's anticipated export performance was one of the conditions for the grant of the subsidies. Australia argues that this consideration would lead to a result that would penalize small economies, where firms are often dependent on exports in order to achieve rational economic levels of production. Nevertheless, in the specific circumstances of this case, we find this consideration compelling evidence of the close tie between anticipated exportation and the grant of the subsidies.

9.68 We note that confidential business information provided by Australia indicates that, in fact, the proportion of Howe's sales going to export has not increased. However, we must make our determination on the facts that existed at the time the contract establishing the conditions for the grant payments was entered into. Thus, the fact that the anticipated exports may not have come to pass in the volumes anticipated does not affect our conclusion. Moreover, we note that confidential business information provided by Australia strongly suggests to us that the expectation of continued and increasing exports was an element in the assessment of Howe's compliance with the terms of the grant contract.

whether the information is corroborated elsewhere or contrary evidence is offered, in assessing the value of these exhibits as evidence.

²¹¹ In this regard, we note that Australia commissioned a report from an independent accounting firm concerning Howe's business, apparently in an effort to determine the nature and amount of financial assistance necessary to maintain Howe's commercial viability. However, although requested, this report was unfortunately not provided to the Panel, which considered that it would provide useful information on the circumstances surrounding the design of the financial assistance package to Howe. See, in particular, *supra*, paras. 6.10(a)-6.11.

²¹² In this regard, we note that while Australia did not agree with the United States estimates concerning the size of the domestic market for automotive leather, calling it conservative, Australia did not provide any contrary or different forecasts upon which we might rely. See *supra*, para. 7.248. In these circumstances, we conclude that Australia has entirely failed to rebut the United States assertion on a question of fact, and we accept the United States estimates.

9.69 Australia insists that the fact that the grant contract was provided only to Howe, which exports a large proportion of its production, and not to any leather manufacturer that supplies the domestic market is irrelevant, since Howe was the only company affected by the removal of automotive leather from eligibility under the ICS and EFS programmes. Australia has confirmed that Howe is the only dedicated producer and exporter of automotive leather in Australia.²¹³ Australia specifically stated, in response to the Panel's question, that aside from the grant and loan to Howe, Australia does not have any subsidy specific to the Australian leather industry.²¹⁴ In our view, the fact that the government of Australia provided the subsidies in question only to Howe, the only *exporter* of automotive leather, is relevant, and supports the conclusion that one of the conditions for the subsidy was anticipated exportation and/or export earnings.

9.70 Australia argues that, because the grant funds cannot be taken back by the government once the payments are made, and because a change in Howe's level of exports would not affect the disbursement of the funds, the grant payments are not "in fact" contingent upon export performance. However, as noted above, in our view the pertinent consideration is the facts at the time the conditions for the grant payments were established, and not possible subsequent developments.

9.71 All of the facts, weighed together, lead us to conclude that the three subsidy payments under the grant contract are in fact tied to Howe's actual or anticipated exportation or export earnings.²¹⁵ These payments are conditioned on Howe's agreement to satisfy, on the basis of best endeavours, the aggregate performance targets. The second and third grant payments are, in addition, explicitly conditioned on satisfaction, on a best endeavours basis, of interim sales performance targets. Given the export-dependent nature of Howe's business, and the size of the Australian market, these sales performance targets are, in our view, effectively, export performance targets. The sales performance targets set out in the grant contract, in conjunction with the other facts enumerated above, therefore lead us to the conclusion that the grant of the subsidies was conditioned on anticipated exportation.

9.72 We therefore conclude that the payments under the grant contract are subsidies "contingent ... in fact" on export performance in violation of Article 3.1(a) of the SCM Agreement.

(ii) *the loan contract*

9.73 The loan contract provides for a fifteen-year loan of \$A25 million by the Government of Australia to Howe/ALH. For the first five-year period of this loan, Howe/ALH is not required to pay principal or interest. After the expiration of this five-year period, interest on the loan is to be based on the rate for Australian Commonwealth Bonds with a ten-year maturity, plus two percentage points. The loan is secured by a second lien over the assets and undertakings of ALH.

9.74 There is nothing in the loan contract that explicitly links the loan to Howe's production or sales, and therefore nothing in its terms, the design of the loan payment, or the repayment provisions that would tie the loan directly to export performance, or even sales performance. Australia argues that under the loan contract, the level of production and sales is irrelevant so long as the company pays the government any monies owing.²¹⁶ The United States responds that the "viability of the loan is necessarily contingent upon Howe's export earnings"²¹⁷ given that the Australian government has

²¹³ Response by Australia to Question 13 of the Panel, 17 December 1998.

²¹⁴ Response by Australia to Question 14 of the Panel, 17 December 1998.

²¹⁵ We note that our conclusion matches the understanding of the recipient of the subsidy payments. In March 1997, Schaffer Corporation, the parent of Howe and ALH, reported that the Australian government had "finalised a compensation package" for Howe/ALH, consisting, *inter alia* of "A grant of [A]\$30 million based on projected exports and paid on performance criteria". Schaffer Corporation Limited Half Yearly Results to December 1996, Exhibit 1 to United States first submission, at page 2.

²¹⁶ Australia's first submission, para. 133, *supra*, para. 7.253.

²¹⁷ United States second submission, para. 41, *supra*, para. 7.258.

acknowledged that the financial assistance provided for in the loan and grant contracts is the minimum amount necessary to ensure the viability of Howe, and that Howe has no choice but to export in order to maintain its production and sales levels in order to remain in business and pay off the loan. The United States asserts that, "[i]f Howe does not export, the Australian government will not be repaid".²¹⁸

9.75 While it may be true that some of the money to repay the loan is likely to be generated through export sales, we agree with Australia that it is ultimately up to Howe and ALH to decide upon the source of funds that will be used to repay the loan. The source of funding will not necessarily be export sales, and there is nothing in the facts before us to suggest that it was expected at the time the loan was entered into that export sales would generate the funds to repay the loan. In our view, the mere fact that one possible source of funds to pay off the loan is potential export earnings is insufficient to conclude that the loan was contingent in fact upon anticipated exportation or export earnings. In this regard, we note that Howe is a subsidiary of ALH and that ALH has other businesses and produces other products from which it could generate the funds to repay the loan. We recognize that other facts are relevant to our consideration of the nature of the loan contract. Included among these is the significance of exports in Howe's business, and the fact that loan was part of the overall "assistance package" given to Howe, which Australia acknowledged would probably not have occurred if Howe had not been removed from eligibility under the ICS and EFS programmes. However, the loan is secured by a lien on the assets and undertakings of ALH, which is itself responsible for repayment of the loan, and not merely on the assets and undertakings of Howe. Moreover, there is nothing in the terms of the loan contract itself which suggests a specific link to actual or anticipated exportation or export earnings, as there is in the terms of the grant contract. These factors persuade us that there is not a sufficiently close tie between the loan and anticipated exportation or export earnings.

9.76 Therefore, we conclude that the loan contract is not "contingent ... in fact ... upon export performance" within the meaning of Article 3.1(a) of the SCM Agreement.

X. CONCLUSIONS AND RECOMMENDATION

10.1 In conclusion, we find that:

(a) The loan from the Australian government to Howe/ALH is not a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement;

(b) The payments under the grant contract are subsidies within the meaning of Article 1 of the SCM Agreement which are contingent upon export performance within the meaning of Article 3.1(a) of that Agreement.

10.2 Pursuant to Article 3.8 of the DSU, the finding in paragraph 10.1(b) also constitutes a case of *prima facie* nullification or impairment of benefits accruing to the United States under the SCM Agreement, which Australia has not rebutted.

10.3 Accordingly, pursuant to Article 4.7 of the SCM Agreement, we recommend that Australia withdraw the subsidies identified in paragraph 10.1(b) above without delay.

10.4 Article 4.7 further provides that "the panel shall specify in its recommendation the time-period within which the measure [*i.e.*, the measure found to be a prohibited subsidy] must be withdrawn". This is one of the first cases involving export subsidies to have been brought before the WTO, and there is consequently no experience or prior practice as to what factors should be

²¹⁸ *Ibid.*

considered in establishing the time-period within which the measure must be withdrawn. Presumably, the nature of the measures and issues regarding implementation might be relevant.

10.5 Australia has argued that, since the "normal" period of time for implementation of panel decisions under the DSU is fifteen months, and time periods in export subsidy disputes are halved pursuant to Article 4.12, a period of seven and one-half months would be appropriate.

10.6 Even assuming Australia is correct in its consideration of fifteen months as the "normal" period of time for implementation of panel decisions, a question we do not reach, we do not agree that one-half of that period is appropriate in a dispute involving export subsidies. In the first place, Article 4.12 specifically provides that "except for time periods specifically prescribed in this Article" the time periods otherwise provided for in the DSU should be halved in export subsidy disputes. Article 4.7, which provides that the subsidy shall be withdrawn "without delay", and that the panel shall specify the time-period for withdrawal of the measure in its recommendation, in our view establishes that the time-period for withdrawal is "specifically prescribed in this Article", that is, in Article 4 of the SCM Agreement itself. Moreover, we do not, as a factual matter, believe that a period of seven and one-half months can reasonably be described as corresponding to the requirement that the measure must be withdrawn "without delay".

10.7 In light of the nature of the measures, we consider that a 90-day period would be appropriate for the withdrawal of the measures. We therefore recommend that the measures be withdrawn within 90 days.
