

ANNEX A

SUBMISSIONS OF CANADA

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ANNEX A-1

FIRST SUBMISSION BY CANADA

(2 March 2001)

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I. INTRODUCTION

1. The issue in this proceeding is whether certain revisions, made on 6 December 2000 to Brazil's *Programa de Financiamento às Exportações* (PROEX)¹ bring PROEX into conformity with the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement) and the findings and the recommendations of the Panel, as modified by the Appellate Body, and adopted by the Dispute Settlement Body (DSB) in *Brazil – Export Financing Programme for Aircraft* (PROEX).² Brazil contends that they do. Canada's position is that they do not.

2. This is the second time that Brazil has claimed that it has complied with the recommendations and rulings of the DSB and the second time that Canada has sought recourse to Article 21.5 of the Dispute Settlement Understanding (DSU) in this dispute. Brazil made the same claim in respect of previous modifications to the original PROEX program made in response to the 20 August 1999 DSB rulings.

3. In its Report of 28 April 2000, this same Panel found that payments in respect of regional aircraft under modifications to PROEX made as of 19 November 1999 ("PROEX II") are export subsidies prohibited by Article 3 of the SCM Agreement and that, accordingly, Brazil had failed to implement the recommendation of the DSB to withdraw its export subsidies for regional aircraft under PROEX within 90 days.³ On appeal by Brazil, the Appellate Body, in its Report of 21 July 2000, upheld the Panel's conclusions.⁴

4. Canada has brought this proceeding because there is, again, a disagreement as to the consistency with the SCM Agreement of measures taken by Brazil that purport to comply with the recommendations and rulings of the DSB.

5. Brazil considers that by limiting its interest rate buy-down payments under PROEX to the Commercial Interest Reference Rate ("CIRR") established under the Organization for Economic Cooperation and Development's Arrangement on Guidelines for Officially Supported Export Credits (the "OECD Arrangement"), it has brought PROEX into compliance with the SCM Agreement. However, as Canada will show, payments made under the latest revisions to PROEX continue to be prohibited subsidies under Articles 1 and 3 of the SCM Agreement. Contrary to Brazil's claims, these prohibited subsidies cannot be sheltered under an *a contrario* exception allegedly found in Item (k) of Annex I to the SCM Agreement because no such exception exists. Even if such an exception does exist, Brazil's PROEX payments do not qualify for it because they are not "payments" within the meaning of Item (k) and because they secure a material advantage in the field of export credit terms.

II. FACTS

6. The revisions at issue are set out in the Central Bank of Brazil (BCB) Resolution No. 2799 of 6 December 2000. Resolution 2799 is entitled: "Redefining the rules applicable to transactions under the interest rate equalization system of the Export Financing Program – PROEX".⁵

¹ "Redefining the rules applicable to transactions under the interest rate equalization system of the Export Financing Program – PROEX," Central Bank of Brazil (BCB) Resolution No. 002799 (6 December 2000) [hereinafter "Resolution 2799"]. (Exhibit CDA-1)

² WT/DS46/R and WT/DS46/AB/R, Reports of the Panel and the Appellate Body, adopted 20 August 1999.

³ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, 28 April 2000, para. 6.106 [hereinafter "Article 21.5 Panel Report"].

⁴ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, para. 82 [hereinafter "Article 21.5 Appellate Body Report"].

⁵ Resolution 2799, *supra* note 1.

7. Resolution 2799 makes only one material revision to the PROEX II program that has already been found to be inconsistent with the SCM Agreement: it provides that interest rate buy-downs offered under PROEX shall be established "in accordance with the Commercial Interest Reference Rate (CIRR), published each month by the OECD, for the respective currency and financing term of the transaction."⁶ In all other material respects, PROEX remains unchanged. Canada will refer to the PROEX program as revised by Resolution 2799 as "PROEX III".

8. By virtue of Article 10 of Resolution 2799, PROEX III applies to all transactions approved by the Committee on Export Credits (the "Committee") on or after 6 December 2000, the date it was published in the official gazette. In the light of Brazil's constant position that it cannot affect prior commitments, it is reasonable to infer that PROEX III does not modify commitments made before 6 December 2000. Moreover, nothing in Resolution 2799 indicates that it has a retroactive effect.

9. Other than the requirement that interest rate buy-downs shall be "in accordance with" the CIRR, the basic elements of the PROEX program found by the original Panel and confirmed in the Article 21.5 Panel Report,⁷ remain the same under PROEX III:

- (a) PROEX payments continue to be grants from the Brazilian National Treasury to buy down commercial interest rates freely negotiated by the borrower;
- (b) the program is still administered by the Committee; and
- (c) the interest rate buy-down payments made under PROEX are still being provided at the time of export of the aircraft in the form of non-interest bearing National Treasury Bonds (Notas do Tesouro Nacional – Série I) referred to as NTN-I bonds. These are denominated in Brazilian Reals indexed to the United States dollar.

10. Under PROEX III, the length of the financing term continues to determine the percentage of the interest rate buy-down and the maximum specified term continues to be 10 years as set out in BCB Newsletter No. 2881 of 19 November 1999.⁸ However, the Committee retains its authority to extend the length of the financing term beyond ten years – as it did consistently, as found by the Panel in the first Article 21.5 proceedings.⁹ PROEX payments also continue to be applied to financing covering 100 percent of the value of the exported aircraft.¹⁰

11. In the weeks before Resolution 2799 was made operational, Brazil's then Foreign Minister, Luis Felipe Lamprea confirmed how Brazil intends to apply PROEX III. He said:

⁶ The English translation of Article 1 of the Resolution reads as follows:

Article 1: In financing transactions for the export of goods and services, as well as of computer programs ("software") referred to in Law No. 9609 of February 19, 1998, the National Treasury may grant to the financing or refinancing party, as the case may be, equalization sufficient to make the financial charges consistent with those prevailing in the international market.

Paragraph 1: In financing for the export of aircraft for regional aviation, interest rate equalization shall be established transaction by transaction, at levels that may differ depending on the characteristics of each transaction, in accordance with the Commercial Interest Reference Rate (CIRR), published each month by the OECD, for the respective currency and financing term of the transaction.

Paragraph 2: Equalization is fixed and limited, for its entire duration, to the percentages established by the Central Bank of Brazil.

⁷ *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999, paras. 2.2-2.6 [hereinafter "Original Panel Report"]; Article 21.5 Panel Report, paras. 2.1-2.6.

⁸ "Establishing maximum percentages for the tax rate equalization system under the Export Financing Program – PROEX," Banco Central do Brasil Newsletter No. 002881, 19 November 1999. (Exhibit CDA-2)

⁹ As the Panel found, "the most frequent waiver has been to extend the length of the financing term from 10 to 15 years. (Article 21.5 Panel Report, para. 2.4).

¹⁰ See Original Panel Report, paras. 4.162-4.163 and 7.91.

For us, the interest rate is the OECD rate, the coverage is 100% and there are no limits on the length of terms.¹¹

12. In effect, the only discipline that Resolution 2799 imposes on PROEX payments is that they must be "in accordance with the CIRR". At the 12 December 2000 meeting of the DSB, Brazilian officials stated that this wording prohibits buy-downs to interest rates below the relevant CIRR,¹² although clearly the phrasing "in accordance with" imposes no such explicit discipline.

13. According to Resolution 2799, the CIRR "limitation" is based on the applicable CIRR "for the respective currency *and financing term of the transaction*" [emphasis added].¹³ The wording of the Resolution recognises that the currency and financing term of the transaction will determine the applicable CIRR. Under the OECD Arrangement, the maximum term allowable for CIRR financing in the regional aircraft sector is ten years.¹⁴ There is no applicable CIRR for a financing term of more than ten years. However, Brazil has clearly indicated that it will impose "no limits on the length of terms".¹⁵ This statement and the financing term of the market for regional aircraft transactions, which typically is fifteen years or more, cannot be reconciled with the Resolution. In effect, the CIRR "limitation" in Resolution 2799 is meaningless.

III. THE JURISDICTION OF THIS PANEL UNDER ARTICLE 21.5

14. Under Article 21.5 of the DSU, the Panel must determine whether a measure taken to comply with the recommendations and rulings of the DSB is consistent with a covered agreement.¹⁶

15. In the context of this proceeding, the Panel must determine whether, as a result of the modifications made by Resolution 2799, PROEX III is consistent with Brazil's obligations under Articles 3.1(a) and 3.2 of the SCM Agreement to neither grant nor maintain such subsidies and Article 4.7 of the SCM Agreement to withdraw the prohibited subsidy. As demonstrated below, PROEX III does not comply with these obligations.

16. This dispute has been ongoing since 1998, when Canada successfully challenged the original PROEX program ("PROEX I") as a prohibited export subsidy. This Panel, in the original proceeding, found that interest equalisation payments made under PROEX I for the benefit of purchasers of exported Brazilian regional aircraft were subsidies contingent upon export performance. The Panel further found that these subsidies were not covered by any exceptions or affirmative defences under the SCM Agreement and were therefore prohibited in accordance with Article 3 of that Agreement. The Appellate Body upheld these findings. The Panel recommended that Brazil withdraw these prohibited export subsidies within ninety days of the adoption of its report by the DSB, that is, by 18 November 1999. Brazil still has not done so.

17. In its 28 April 2000 Report, this Panel also found that by continuing to issue NTN-I bonds pursuant to letters of commitment issued under PROEX I as it existed before 18 November 1999,

¹¹ M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Econômico* (30 October 2000). (Exhibit CDA-3)

¹² Statement by Brazil: DSB Meeting of 12 December 2000: Agenda Item 3: *Brazil – Export Financing Programme for Aircraft: Implementation of the recommendations of the DSB* [hereinafter "Brazil's 12 December 2000 DSB Statement"]. (Exhibit CDA-4)

¹³ Resolution 2799, *supra* note 1, Article 1, para. 1.

¹⁴ OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998), Annex III, Part 2, Article 21. (Exhibit CDA-5)

¹⁵ *Supra* note 11.

¹⁶ Article 21.5 states, in relevant part:

Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. ...

Brazil was continuing to grant subsidies contingent upon export performance within the meaning of Article 3.2 of the SCM Agreement.¹⁷ Brazil also appealed, unsuccessfully, this conclusion of the Panel in the first Article 21.5 proceeding.

18. Since 18 November 1999, despite the adopted findings of the Panel as upheld by the Appellate Body in the original Article 21.5 proceedings, Brazil has continued to make illegal subsidy payments on aircraft delivered after 18 November 1999 pursuant to commitments made under PROEX I and II both before and after 18 November 1999. In response to this ongoing non-compliance, Canada sought and obtained from the DSB authorization to impose certain countermeasures against Brazil.

19. Therefore, this second Article 21.5 proceeding is to consider only whether PROEX III is consistent with the SCM Agreement. Regardless of the outcome of this proceeding, so long as Brazil continues to make payments under PROEX I and II, it will remain non-compliant with the DSB's recommendation that it withdraw its prohibited export subsidies.

IV. THE BURDEN OF PROOF

20. In the following section, Canada presents evidence that payments under PROEX III on exports of regional aircraft continue to be prohibited export subsidies. In so doing, Canada has met its legal and evidential burden in this proceeding. The burden now shifts to Brazil to establish the three requisite elements of its alleged affirmative defence.¹⁸ Brazil needs to prove:

- (i) that the first paragraph of Item (k) of Annex I to the SCM Agreement gives rise to an *a contrario* exception; and that PROEX payments qualify for this alleged exception in that:
- (ii) the PROEX payments are the payment by governments of all or part of the costs incurred by exporters or financial institutions in obtaining credits; and
- (iii) the PROEX payments are not used to secure a material advantage in the field of export credit terms.

21. Although the shifting of the burden to Brazil obviates the need for Canada to address the three elements of the alleged defence that Brazil has implied that it will rely on,¹⁹ Canada will show in this submission that Brazil cannot establish any of these elements.

22. It is evident that in an effort to continue providing illegal export subsidies, Brazil intends to exploit any alleged ambiguity and any judicial economy exercised by the Panel and the Appellate Body in this dispute. In the circumstances, it is essential that the Panel issue detailed findings on all three elements of Brazil's defence in order to facilitate the effective resolution of this dispute.²⁰

¹⁷ Article 21.5 Panel Report, para. 6.17.

¹⁸ Before the Original Panel, Brazil explicitly acknowledged that its alleged Item (k) exception constituted an affirmative defence and that the burden of establishing the defence was on Brazil: Original Panel Report, at para. 7.17. As in the previous Article 21.5 proceeding in this dispute, the burden of proof lies with Brazil in that it is using Item (k) to make an affirmative claim in its defence. Article 21.5 Appellate Body Report, para. 66; *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, p. 16.

¹⁹ Brazil's 12 December 2000 DSB Statement, *supra* note 12.

²⁰ As articulated by the Appellate Body, a panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings and the effective resolution of the dispute: *Australia – Measures Affecting the Importation of Salmon*, WT/DS18/AB/R, adopted

V. LEGAL ARGUMENT

A. PROEX III PAYMENTS CONTINUE TO BE PROHIBITED SUBSIDIES UNDER ARTICLES 1 AND 3 OF THE SCM AGREEMENT

23. As has been confirmed twice before by both the Panel and the Appellate Body, PROEX payments continue to involve a direct transfer of funds from the Government of Brazil that confers a benefit.²¹ Accordingly, PROEX III involves "subsidies" within the meaning of Article 1 of the SCM Agreement. The subsidies are *de jure* contingent upon export performance within the meaning of Article 3.1(a) of that Agreement. Accordingly, they are prohibited under Articles 3.1 and 3.2.

24. It is implicit in Brazil's statement to the DSB on 12 December 2000, which is grounded in Brazil's alleged Item (k) exception, that Brazil continues to acknowledge that PROEX subsidies are prohibited export subsidies.²² Nevertheless, Brazil has changed nothing about PROEX except the maximum interest rate buy-down. This presumably is the basis for Brazil's contention that since 6 December, PROEX "fully conforms to WTO disciplines".²³ This contention appears to be based entirely on the revisions in Resolution 2799 that provide that PROEX interest rate buy-downs shall be established "in accordance with" the CIRR,²⁴ and on Brazil's belief that this qualifies PROEX for an *a contrario* exception under its theory of Item (k) and its PROEX program.

25. Thus, at the 12 December 2000 meeting of the DSB, at which Brazil announced that Resolution 2799 was "operational", Brazil stated that it:

... chose to revise PROEX so as not to allow for payments that result in interest rates below the relevant CIRR. Furthermore, the Committee on Export Credits (CCEx) will approve equalization for regional aircraft financing having as a benchmark the financing conditions existing in the international market. With these parameters, PROEX has been brought into full conformity with Brazil's obligations under the Agreement on Subsidies and Countervailing Measures and the GATT 1994.²⁵

B. BRAZIL CANNOT ESTABLISH AN AFFIRMATIVE DEFENCE

26. Brazil appears to be contending that by requiring its interest rate buy-down payments under PROEX to be made "in accordance with the CIRR", it has sheltered PROEX III under an alleged *a contrario* exception in the first paragraph of Item (k) of Annex I to the SCM Agreement.

27. In accordance with the prior findings of this Panel and the Appellate Body, in order for Brazil to escape the prohibition in Article 3 of the SCM Agreement, it must establish that:

- (i) The first paragraph of Item (k) of Annex I is an *a contrario* exception; and that PROEX payments qualify for that exception because:

6 November 1998, para. 223; *United States – Definitive Safeguard Measures On Imports Of Wheat Gluten from The European Communities*, WT/DS166/AB/R, adopted 19 January 2001, para. 180.

²¹ The nature of PROEX equalization payments as prohibited export subsidies was discussed in the Original Panel Report at para. 7.13. This nature has not changed.

²² Brazil acknowledged that PROEX equalization payments were prohibited export subsidies under both PROEX I (see para. 7.12 of the Original Panel Report) and PROEX II (see para. 6.7 of the Article 21.5 Panel Report).

²³ Statement by Brazil: DSB Meeting of 16 February 2001: Agenda Item II: *Brazil – Export Financing Programme for Aircraft*, para. 3. (Exhibit CDA-6)

²⁴ Resolution 2799, *supra* note 1, Article 1, para. 1.

²⁵ Brazil's 12 December 2000 DSB statement, *supra* note 12.

- (ii) PROEX payments are the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits"; and
- (iii) PROEX payments are not "used to secure a material advantage in the field of export credit terms".²⁶

28. As demonstrated below, Brazil cannot establish any of these elements. Accordingly, payments made pursuant to PROEX III are prohibited export subsidies under Article 3 of the SCM Agreement.

1. The First Paragraph of Item (K) Cannot Be Interpreted As An *A Contrario* Exception

(a) The Nature of Brazil's *A Contrario* Argument

29. The foundation of Brazil's position appears to be that the first paragraph of Item (k) of the Illustrative List under Annex I can be interpreted *a contrario sensu* to create an exception to the prohibition in Article 3.1 of the SCM Agreement for measures that in some respect fall outside of the description of the export subsidy illustrated in the first paragraph of Item (k).²⁷

30. In the past, Brazil has argued that its otherwise prohibited PROEX export subsidies are exempt from the obligations of Article 3 of the SCM Agreement because it considered that the first paragraph of Item (k) of the Illustrative List creates an exception *a contrario* for practices similar to those described in the first paragraph but which do not meet all of the terms of that description.

31. Brazil has argued further, that various iterations of PROEX meet the terms of this alleged exception because PROEX provided, in Brazil's view, the type of payments that *are* discussed in Item (k) first paragraph, but that these payments, according to Brazil, did not secure a material advantage in the field of export credit terms.

32. In the context of the PROEX case, Brazil infers from the text of the first paragraph of Item (k), which refers only to export credits and payments used to secure a material advantage, that when such activities are not used to secure a material advantage, they are not export subsidies that are subject to the prohibition in Article 3.1.

(b) The Applicable Rules of Treaty Interpretation

(i) *The A Contrario Maxim Cannot Be Applied Automatically*

33. The *a contrario* exception is another way of referring to one of the maxims of statutory and treaty interpretation, that is, *expressio unius est exclusio alterius* (to express one thing is to exclude another).²⁸ Its basic rationale is as follows: given what has been expressly set out in a text, it is plausible to infer that the drafters intended to exclude similar things that are not expressly mentioned.

34. The argument is based on the expectation that if the drafters had meant to include a similar or related thing within the ambit of a treaty provision, they would have referred to that thing expressly. The failure to mention such a thing then becomes a basis for inferring that it was deliberately excluded.

²⁶ Article 21.5 Appellate Body Report, para. 58.

²⁷ "*A contrario sensu*" means "on the other hand; in the opposite sense". (*Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 23. (Exhibit CDA-7))

²⁸ Lord McNair, *The Law of Treaties* (Oxford: Clarendon Press, 1961), p. 400 [hereinafter "McNair"]. (Exhibit CDA-8)

35. So-called canons or maxims of interpretation, such as *expressio unius est exclusio alterius* or the *a contrario* approach, are not automatic in their application. They have not attained the status of customary rules of interpretation of public international law, although they are sometimes referred to in the decisions of international tribunals.²⁹

36. The International Law Commission's final recommendations about the interpretation of treaties make it clear that the application of any given maxim depends upon discretion and will not be suitable in all cases:

Their suitability for use in any given case hinges on a variety of considerations which have first to be appreciated by the interpreter of the document; the particular arrangement of the words and sentences, their relation to each other and to other parts of the document, the general nature and subject-matter of the document, the circumstances in which it was drawn up, etc. Even when a possible occasion for their application may appear to exist, their application is not automatic but depends on the conviction of the interpreter that it is appropriate in the particular circumstances of the case. In other words, recourse to many of these principles is discretionary rather than obligatory ...³⁰

37. Thus, the *a contrario* reasoning advocated by Brazil is not of universal application. In fact, in the form of *expressio unius est exclusio alterius*, the *a contrario* approach can be an unreliable tool and must be used with caution. In *The Law of Treaties*, Lord McNair gave warnings as to the possible misapplication of this maxim:

That there is a substantial element of truth in this maxim is obvious But, like other maxims, it must be regarded as a 'valuable servant' and not allowed to become a 'dangerous master', and must be applied with caution.³¹

38. He cited an English case to the effect that:

The exclusio [*i.e.*, the thing not expressly mentioned] is often the result of inadvertence or accident, and the maxim ought not to be applied, when its application, having regard to the subject matter to which it is to be applied, leads to inconsistency or injustice".³²

39. Accordingly, whether a provision gives rise to an *a contrario* interpretation depends very much upon the context of the provision being interpreted. Brazil's contention that Item (k) should be interpreted as containing an implicit *a contrario* exception must therefore be examined, like any other claim as to the interpretation of a treaty provision, in accordance with those rules of treaty interpretation that, having attained the status of customary international law, are automatic in their application.

(ii) *The General Rule Of Interpretation In Article 31 of the Vienna Convention And The Principle Of Effectiveness*

²⁹ G.G. Fitzmaurice, "The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points," (1951) 28 B.Y.I.L. 1.; and Sir G. Fitzmaurice, "The Law and Procedure of the International Court of Justice 1951-4: Treaty Interpretation and Certain Other Treaty Points," (1957) 33 B.Y.I.L. 203. (Exhibits CDA-9 and CDA-10)

³⁰ "Report of the International Law Commission on the work of its eighteenth session" (U.N. Doc. A/6309/Rev. 1) in *Yearbook of the International Law Commission 1966*, vol. II, Part II (New York, 1966) (UN Doc. A/CN.4/Ser.A/1966/Add.I), p. 218. (Exhibit CDA-11)

³¹ McNair, *supra* note 28, p. 400.

³² *Ibid.*, quoting *Colquhoun v. Brooks*, 21 Q.B.D. 52, p. 65.

40. It is well established that the starting point for interpreting a WTO agreement or a provision such as Item (k), is the general rule of interpretation in Article 31 of the *Vienna Convention on the Law of Treaties* (the "Vienna Convention").³³

41. According to the general rule, treaty interpretation begins with a careful reading of the text. Treaty terms must be given their ordinary meaning unless the text indicates that a term is intended to have a special meaning. The ordinary meaning of a term is determined in the context of the treaty and in the light of the treaty's object and purpose.

42. The Appellate Body has also recognized that the principle of effectiveness in the interpretation of treaties (*ut res magis valeat quam pereat*) is a fundamental tenet of treaty interpretation flowing from this general rule.³⁴ The principle of effectiveness requires that a treaty interpreter:

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.³⁵

43. The Appellate Body has elaborated upon this principle, stating that:

- (i) It is the *duty* of any treaty interpreter to read all applicable provisions of a treaty in a way that gives meaning to *all* of them harmoniously;
- (ii) An important corollary of this principle is that a treaty should be interpreted as a whole, and, in particular, its sections and parts should be read as a whole; and
- (iii) *All of the provisions* of a treaty must be given meaning and legal effect.³⁶

³³ United States – Standards for Reformulated and Conventional Gasoline, WT/DS2/AB/R, adopted 20 May 1996, pp. 16-17 [hereinafter United States – Gasoline]. Article 3.2 of the WTO's Understanding on the Rules and Procedures Governing the Settlement of Disputes (DSU) requires WTO Agreements (including the SCM Agreement) to be interpreted in accordance with "customary rules of interpretation of public international law". These rules are set out in the Vienna Convention. Article 31 of the Vienna Convention reads as follows:

Article 31

General rule of interpretation

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

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

[...]

4. A special meaning shall be given to a term if it is established that the parties so intended.

³⁴ *United States – Gasoline*, p. 23; *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R; WT/DS810/AB/R; WT/DS11/AB/R, adopted 1 November 1996, p. 11; *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999, para. 179, note 110 [hereinafter "Original Appellate Body Report"]; *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R, adopted 12 January 2000, paras. 80-82 [hereinafter *Korea – Dairy Safeguards*].

³⁵ *Ibid.*, para. 80.

³⁶ *Ibid.*, paras. 81-82. [emphasis in the original].

44. The principle of effectiveness is particularly relevant to the interpretation of the first paragraph of Item (k). To the extent that the paragraph is open to two interpretations – *i.e.*, it does or does not offer an *a contrario* exception – the interpretation that gives meaning and legal effect to all of the applicable provisions of the SCM Agreement must be adopted. As the following analysis demonstrates, this is achieved only if Item (k) is interpreted as not offering an *a contrario* exception.

(c) The Applicable Provisions of the SCM Agreement

45. In addition to Annex I, the applicable provisions of the SCM Agreement are the prohibition in Article 3 and the corresponding footnotes. These read as follows:

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;

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

Footnote 4: This 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.

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

46. These provisions provide important context for the interpretation of Item (k). Moreover, Item (k) must not be interpreted in such a way as to deprive these provisions of meaning.

(i) Footnote 5

47. Footnote 5 is particularly important to the analysis of Brazil's claim that its export subsidies are permitted by Item (k), because footnote 5 recognizes that Annex I contains certain exceptions to the prohibition in Article 3. Brazil's claim can have no basis outside of footnote 5. As an explicit exclusionary clause, footnote 5 precludes the possibility of relying on an implied exclusion based on an alleged *a contrario* exception independent of footnote 5. The Panel recognized this in its original Article 21.5 Report where it stated:

If we were to conclude that the Illustrative List by implication gave rise to "permitted" measures beyond those allowed by footnote, we would be calling into serious question the *raison d'être* of footnote 5.³⁷

48. That is, if simply by identifying certain types of measures as prohibited export subsidies, the Illustrative List could be said implicitly to allow other subsidies, footnote 5 would be redundant. The principle of effectiveness precludes this result. Accordingly, Brazil's legal argument that an *a contrario* exception exists in the first paragraph of Item (k) must somehow be grounded in footnote 5.

³⁷ Article 21.5 Panel Report, para. 6.41. Moreover, the Article 21.5 Panel Report stated, at para. 5.3, that "footnote 5 controls the interpretation of item (k) with respect to when the Illustrative List can be used to demonstrate that a measure is not a prohibited subsidy".

49. In its Report in the previous Article 21.5 proceeding, the Appellate Body, in *obiter dictum* stated that it would have been prepared to find that Brazil's PROEX II payments were justified under Item (k) if Brazil could have demonstrated that those payments satisfied the other two elements again at issue here (which it could not). However, it also stated that:

... we wish to emphasize that we are not interpreting footnote 5 of the *SCM Agreement*, and we do not opine on the scope of footnote 5, or on the meaning of any other items in the Illustrative List.³⁸

50. In Canada's view, it is impossible to reach a conclusion as to the existence of an *a contrario* exception without interpreting the language of footnote 5. Along with Article 3.1(a) of the *SCM Agreement*, footnote 5 and the other items in the Illustrative List constitute the immediate context of Item (k). In accordance with Article 31 of the *Vienna Convention* any full analysis of the meaning of Item (k) requires that it be considered.

51. For the purpose of assessing the existence of an alleged *a contrario* exception in Item (k) based on footnote 5, the key phrase in footnote 5 is "measures referred to in Annex I as not constituting export subsidies". In order to make out the existence of such an exception, Brazil must establish that a measure impliedly excluded from the list of illustrations in Annex I is a measure "referred to in Annex I as not constituting" an export subsidy. It cannot do so. The ordinary meaning of footnote 5 does not support such an interpretation.

52. A measure impliedly excluded from the Illustrative List is not a measure "referred to" in it. *The New Shorter Oxford English Dictionary* offers as the most relevant definition of "refer": "direct to a fact, event, etc., by drawing attention to it."³⁹ The usual synonyms for "referred to" – "mentioned, cited, named" – also involve a positive reference to something by means of words or other symbols.⁴⁰

53. In legal instruments, matters are referred to by words. If something must be "referred to" in a written text, the thing must be named or described in words set out in the text. Otherwise the thing would not be referred to *in* the text. Since a text consists of expressed language, a reference *in* a text must equally consist of expressed language. The Appellate Body recognized this in *United States – Tax Treatment for "Foreign Sales Corporations"* where it described footnote 5 as applying "where the Illustrative List *indicates* that a measure is not a prohibited export subsidy".⁴¹

54. Footnote 5 does not require that the words "is not an export subsidy" be used in the Illustrative List. Rather, it requires positive authorizing language in Annex I that a measure is not being categorized as a prohibited subsidy.⁴² To find otherwise would nullify the meaning and legal effect of the phrase "referred to in" and, therefore, would be inconsistent with the principle of effectiveness as articulated by the Appellate Body.

³⁸ Article 21.5 Appellate Body Report, para. 80.

³⁹ *The New Shorter Oxford English Dictionary on Historical Principles*, v. 2 (Oxford: Clarendon Press, 1993), p. 2520 ("refer"). (Exhibit CDA-12)

⁴⁰ *Oxford Thesaurus: An A-Z Dictionary of Synonyms* (Oxford: Clarendon Press, 1991), p. 384 ("refer"). (Exhibit CDA-13)

⁴¹ WT/DS108/AB/R, adopted 20 March 2000, para. 93. [emphasis altered]

⁴² There are four such statements in Annex I. The second paragraph of Item (k) contains an explicit statement that certain practices shall not be considered a prohibited export subsidy. In three other instances, footnote 59 to Item (e), Item (h) and Item (i), the Annex includes affirmative statements authorizing the use of certain measures without explicitly stating that they do not constitute export subsidies. These statements provide contextual support for Canada's position that the words "measures referred to in Annex I as not constituting export subsidies" in footnote 5 means measures for which there are positive statements in Annex I to indicate that such measures are not export subsidies.

55. Seen in the light of the ordinary meaning of footnote 5, Brazil's contention that its PROEX payments are permitted, *a contrario*, because they are not referred to in Item (k) creates an absurdity. It is this absence of reference from which Brazil infers that its measure is impliedly excluded from the prohibition in Article 3. However, in order to fall within footnote 5, Brazil's measure must be referred to in Item (k). Brazil cannot have it both ways.

(ii) *The Illustrative List*

56. The Illustrative List is illustrative only. That is, it is not an exhaustive list of those measures that are prohibited export subsidies. This is confirmed by the plain language of Article 3.1(a), which prohibits subsidies contingent upon export performance "*including* those illustrated in Annex I." [emphasis added]

57. It was also confirmed by the Panel in *Canada – Measures Affecting the Automotive Industry*. The Panel found that:

it is ... reasonable, in our view, to consider that the Illustrative List may be of some utility in informing the notion of export contingency in certain precise situations. We find it difficult to accept, however, that the practices identified in the Illustrative List represent a circumscription ... of the conditions under which a subsidy is deemed to be contingent upon export performance. Indeed, the use of the words "including" and "illustrated" makes it clear that, while all practices identified in the Illustrative List are subsidies contingent upon export performance, there may be other practices not identified in the Illustrative List that are also subsidies contingent upon export performance.⁴³

58. The Panel's finding confirms that the analysis of whether a given practice falls within the terms of an item in the Illustrative List is not determinative of whether it constitutes a subsidy contingent upon export performance. In other words, the Illustrative List only covers a subset of export subsidies to which the general prohibition applies.

59. In the case of a non-exhaustive illustrative list, an *a contrario* interpretation or the maxim *expressio unius est exclusio alterius* is not applicable. While the Illustrative List defines a part of a whole – that is, examples of export subsidies – it does not prescribe a special rule to be applied only to the examples mentioned. On the contrary, save for measures covered by footnote 5, pursuant to Article 3.1(a) the rule applicable to the whole – the prohibition of export subsidies – is also applicable to the part of the whole mentioned on the Illustrative List.

60. Since no special rule is defined for the Illustrative List, there is no basis to infer that unmentioned export subsidies are subject to a different rule. An *a contrario* interpretation is not possible, because unmentioned export subsidies are covered by the same rule as the expressly mentioned export subsidies.

61. Accordingly, when Item (k) is considered in accordance with the ordinary meaning to be given to the relevant terms of the SCM Agreement in their context, it is clear that Brazil's *a contrario* interpretation is unsustainable.

2. PROEX Payments Are Not The "Payment By [Governments] Of All Or Part Of The Costs Incurred By Exporters Or Financial Institutions In Obtaining Credits"

62. Item (k) of the Illustrative List does not allow for an *a contrario* exception. Even if it did, to qualify for it Brazil would have to show that its payments under PROEX III are of a type covered by

⁴³ WT/DS139/R, WT/DS142/R, adopted 19 June 2000, para. 10.196.

the first paragraph of Item (k) but not "used to secure a material advantage in the field of export credit terms".

63. Item (k) specifically relates to only two types of practices to which the "material advantage" clause applies: (i) export credits granted by governments or certain government-controlled institutions at below their own cost of funds; and (ii) payments by governments of "all or part of the costs incurred by exporters or financial institutions in obtaining credits".

64. Throughout this dispute, Brazil has argued that its PROEX export subsidies are of the latter type. It has contended that they are payments by the Government of Brazil of all or part of the costs incurred by exporters (Embraer) or financial institutions in obtaining credits.⁴⁴

65. Brazil's contention was considered by this Panel in the previous Article 21.5 proceeding. The Panel rejected Brazil's argument.⁴⁵ The Appellate Body subsequently declared the Panel's findings to be "moot" because it had already found that Brazil had failed to show that the PROEX payments were not used to secure a material advantage.⁴⁶ Nevertheless, the Panel's findings were clearly correct.

66. The Panel found as follows:

It will be recalled that item (k) refers to the payment by governments of "all or part of the costs incurred by exporters or financial institutions in obtaining credits". In interpreting this provision, we must of course start with its ordinary meaning. In this respect, we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to *obtaining* export credits, and not costs relating to providing them.

Read in light of the foregoing considerations, we do not believe that PROEX payments can be said to constitute "the payment by [a government] of all or part of the costs incurred by exporters or financial institutions in obtaining export credits". Brazil's argument equates the cost for a financial institution of raising capital with the cost of "obtaining [export] credits". While the financial institutions involved in financing PROEX-supported transactions certainly *provide* export credits, they cannot be seen as *obtaining* such credits. Further, if the drafters had intended to refer to payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so. In short, we do not agree that payments to a lender that amount to interest rate support can reasonably be understood to be payments of all or part of the costs of obtaining export credits.

Even if we did agree that the provision of export credits at below a financial institution's cost of borrowing entailed a "cost incurred by ... financial institutions in obtaining credits", we are unconvinced that PROEX payments necessarily serve to reimburse such below-cost-of-borrowing export credits. In this respect, we note that Brazil's argument focused on the fact that Embraer and Brazilian financial institutions had a high cost of borrowing as a result of "Brazil risk". As Canada points out, however, Embraer does not itself provide export credit financing, and the financial institutions receiving PROEX payments are not necessarily Brazilian financial institutions. Rather, they are in many cases leading international financial institutions unhampered by "Brazil risk". Thus, there is no basis for us to conclude, nor even to

⁴⁴ Original Panel Report, para. 4.76.

⁴⁵ Article 21.5 Panel Report, paras. 6.69-6.73.

⁴⁶ Article 21.5 Appellate Body Report, para. 78.

hypothesise, that the financial institutions in question are providing export credits at below their cost of funds.⁴⁷

67. As the Panel noted, the ordinary meaning and context of the "payment" clause in the first paragraph of Item (k) makes clear that the costs referred to are those relating to *obtaining* export credits and not those relating to providing them. The first part of the first paragraph of Item (k) refers to the cost incurred by a government in granting export credits at rates below its own borrowing cost. The second part of the paragraph refers to a situation where a government covers the same cost incurred by a financial institution or an exporter.

68. PROEX payments do not reimburse an exporter or a financial institution for the costs it incurs in "obtaining" export credits. Instead, they buy down commercially negotiated interest rates for a purchaser of exported goods to below market rates. As such, they are not "payments" within the meaning of the second part of the first paragraph of Item (k).

69. Accordingly, PROEX payments would not qualify for any *a contrario* exception under Item (k), even if such an exception existed.

3. PROEX Payments Are "Used To Secure A Material Advantage In The Field Of Export Credit Terms"

70. The third element that Brazil would have to demonstrate in order to qualify for its alleged *a contrario* exception under Item (k) is that PROEX payments are not "used to secure a material advantage in the field of export credit terms". Brazil has been unable to demonstrate this in any of the prior proceedings in this dispute. However, it now claims that it has revised PROEX by way of Resolution 2799 "so as not to allow for the payments that result in interest rates below the relevant CIRR" and that this is sufficient to establish the third element.⁴⁸

71. It is very much open to question whether the words of Resolution 2799, which provide that PROEX III buy-downs are to be "in accordance with" the relevant CIRR for the respective currency and financing term of the transaction, actually prohibit buy-downs to below the CIRR as Brazil claims. As noted, the typical financing term for regional aircraft transactions exceeds the 10-year CIRR term. That is, there is no CIRR for the financing term used most often for regional aircraft.

72. Even if for the sake of argument there were a relevant CIRR and the words of Resolution 2799 did prohibit buy-downs below that rate, it is readily demonstrated that, contrary to Brazil's assertions, PROEX III payments provide a "material advantage" as that term should be interpreted in accordance with the SCM Agreement and the relevant panel and Appellate Body findings.

(a) PROEX III Confers a Material Advantage When Compared to Rates Available to Borrowers in the Commercial Marketplace

73. Because PROEX III is constructed as a buy-down of interest rates that have already been freely negotiated by Embraer's customers in the market, the resulting net interest rates will necessarily be below market rates. The Appellate Body has stated that the existence of a "material advantage" depends on where the government interest rate "stands in relation to the range of commercial rates available."⁴⁹ The range of commercial rates available must be interpreted to refer to the commercial rates that are actually available to the borrower in question. The Appellate Body has acknowledged

⁴⁷ Article 21.5 Panel Report, paras 6.71 to 6.73. [emphasis in original]

⁴⁸ Brazil's 12 December 2000 DSB Statement, *supra* note 12.

⁴⁹ Original Appellate Body Report, para. 182. [emphasis added].

that "the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity *as well as the creditworthiness of the borrower.*"⁵⁰

74. Given that PROEX III interest rates are necessarily below the market rates available to the borrower in question, and therefore provide an "advantage," the only question is whether the PROEX rates are sufficiently below market to be considered as providing a "material" advantage. The ordinary meaning of "advantage" is "a more favorable or improved position" or a "superior position".⁵¹ The ordinary meaning of "material" is "serious, important; of consequence."⁵² "Material" is also defined as referring to evidence or facts which are "significant, influential, esp. to the extent of determining a cause, affecting a judgement, etc."⁵³

75. Therefore, a "material advantage" occurs if PROEX III provides a "more favorable" or "superior" position relative to the commercial rates available to the borrower in question, and that improvement is "important" in nature. Alternatively, a "material" advantage occurs where the improvement provided by PROEX III is "significant", especially to the extent of affecting a judgement or determining a cause, *i.e.* influencing the aircraft purchaser's selection of aircraft.

76. Canada has submitted affidavits from airlines and a financial institution indicating that a reduction in interest rates of as little as 25 basis points can have a material impact on a purchaser's choice of aircraft.⁵⁴

77. Assuming that PROEX III buys down the interest rate to the CIRR, it will almost always confer an advantage of more than 25 basis points compared to the commercial rates available to borrowers under similar terms and conditions. The extent to which the CIRR is divorced from market terms is illustrated by comparing the U.S. dollar CIRR (the CIRR rate for terms in excess of 8.5 years is set at a fixed margin of 100 basis points over the 7-year U.S. Treasury bond) with the actual all-in borrowing rates paid by fixed-rate airline borrowers.

78. As shown in the annexed Morgan Stanley Dean Witter Market Update (the "MSDW Report") the airline with the best credit rating (*i.e.*, lowest risk) is American, whose debt currently trades between 135 to 200 basis points above Treasury rates.⁵⁵ That is, even at the lowest end of the lowest risk airline, the 135 basis point spread is still 35 basis points higher than a rate achieved at CIRR alone.

79. The spread between the CIRR and market rates is higher – in some cases far higher – for other, less creditworthy airlines. As the MSDW Report shows, the spread paid by an airline above U.S. Treasury rates can range up to 500 basis points. Thus, even comparing PROEX III to market rates – without taking into consideration other terms and conditions – PROEX confers a material advantage.

80. However, other terms and conditions must also be taken into account. By its express wording, a material advantage under Item (k) is "in the field of export credit terms". Accordingly, the determination of whether a material advantage exists must be based on a consideration of those "export credit terms" and not simply based on a comparison of interest rates.

⁵⁰ *Ibid.* [emphasis added].

⁵¹ *Ibid.*, para. 177.

⁵² *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), pp. 1713-1714 ("material"). See also *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 991 ("material"). (Exhibits CDA-14 and CDA-15)

⁵³ *The New Shorter Oxford English Dictionary* ("material"), *supra* note 51.

⁵⁴ Affidavits from Tyrolean Airways (2 February 2000); Augsburg Airways (1 February 2000); Comair, Inc. (2 February 2000); and CIBC World Markets (2 February 2000). (Exhibit CDA-16)

⁵⁵ "EETC Market Update: Monthly Update: Airlines" (Morgan Stanley Dean Witter, Fixed Income Research, North America, Investment Grade Credit – Industrials) 10 February 2001, p. 13. (Exhibit CDA-17)

81. The Appellate Body identified as "terms and conditions of export credit transactions in the marketplace" the following: "the product involved, the size or volume of the transaction, the type of export credit practice, the duration of the repayment term, the type of interest (fixed or floating) used, and when the transaction is concluded."⁵⁶ As this Panel noted:

In its ordinary meaning, the field of export credit terms would refer to items directly related to export credits, such as interest rates, grace periods, transaction costs, maturities and the like. We consider that this interpretation is supported contextually by item (k) itself, which refers to a loan's "maturity and other credit terms".⁵⁷

82. If these terms and conditions are considered, as they must be under the express terms of the SCM Agreement and prior rulings in this case, they further demonstrate the material advantage provided by PROEX III. As noted previously, the PROEX III repayment period is "unlimited" and the financed amount may be up to 100 percent of the value of the aircraft.⁵⁸ In contrast, the American Airlines spread is based on a loan-to-asset value of only 47% and an average life of roughly 10 years, both of which significantly reduce the risk to the point where the credit is rated as Investment Grade.

83. The significantly longer maturities, and higher loan-to-asset value available under PROEX III would require significantly higher rates in the commercial marketplace. The fact that PROEX III rates are actually lower than commercial rates available to borrowers, despite having significantly longer maturities and higher loan-to-asset values, demonstrates that the program confers a material advantage in the field of export credit terms.

(b) The CIRR Alone Is Not Determinative of Material Advantage

84. Nevertheless, Brazil appears to be claiming that it can establish that PROEX payments do not secure a material advantage so long as they do not buy down interest rates below the CIRR rate. This flies in the face of the very nature of PROEX as a below-market buy-down scheme. Moreover, in advancing this argument, Brazil has misinterpreted the guidance of the Appellate Body.

85. In its Report in the previous Article 21.5 proceeding, the Appellate Body stated:

To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove *either*: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" we identified in the original dispute as an "appropriate" basis for comparison; *or*, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark."⁵⁹

86. Brazil has seized on this statement and cited it as the basis for its contention that PROEX III is in conformity with its WTO obligations.⁶⁰ Its position appears to be that as long as net interest rates under PROEX III will be at or above the relevant CIRR, payments under PROEX III do not secure a material advantage in the field of export credit terms. This is incorrect for several reasons.

87. First, as discussed above, the express terms of the SCM Agreement, as well as the prior findings of the Appellate Body and this Panel, demonstrate that the existence of a "material advantage" must be determined with regard to the field of export credit terms, rather than solely with

⁵⁶ Article 21.5 Appellate Body Report, para. 73.

⁵⁷ Original Panel Report, para. 7.28.

⁵⁸ See *Valor Económico* (30 October 2000), *supra* note 11.

⁵⁹ Article 21.5 Appellate Body Report, para. 67.

⁶⁰ Brazil's 12 December 2000 DSB Statement, *supra* note 12.

respect to the interest rate comparison. Thus, to the extent that the CIRR is a "benchmark", that is, a "point of reference"⁶¹ against which something may be compared, one must still look at the field of export credit terms in order to determine whether a "payment", within the meaning of Item (k) first paragraph, is used to secure a material advantage.

88. In other words, a CIRR benchmark cannot be conclusive on the issue of material advantage because it does not (as interpreted by Brazil in its PROEX III program) take into account the other aspects of the transaction, (*i.e.* maturity, the loan-to-asset value or minimum cash payment to be made, etc.) and the creditworthiness of the borrower.

89. Thus, while the CIRR may be relevant evidence to determine or assess whether a payment is used to secure a material advantage in the field of export credit terms, it cannot, in and of itself, be determinative.

90. That the CIRR alone is not determinative of a material advantage is confirmed by the rules of treaty interpretation. To find that the CIRR alone is determinative of a material advantage would reduce paragraph 2 of Item (k) to redundancy or inutility. No WTO Member would have any incentive to conform their export credit practices to the CIRR and the other requirements of the OECD Arrangement in order to shelter their export subsidies; they could achieve the same result by conforming their practices to the CIRR alone under paragraph 1. Such a result would be contrary to the principle of effectiveness in the interpretation of treaties (*ut res magis valeat quam pereat*) as articulated by the Appellate Body.⁶²

91. Second, an approach that treated the CIRR as conclusive on the issue of material advantage would disregard the Appellate Body's clear ruling that the CIRR may not reflect the rates available in the marketplace, in which case it may be disregarded as a standard in favor of actual market rates. The Appellate Body held that even where an interest rate was below the CIRR, a defending Member could demonstrate that its program did not confer a material advantage, by relying on an alternative "market benchmark."⁶³

92. The Appellate Body's decision with respect to below-CIRR rates was premised on its recognition that in certain circumstances, "the CIRR does not, in fact, reflect the rates available in the marketplace."⁶⁴ Thus, the Appellate Body recognized that the role of the CIRR was to serve as a proxy for the rates available in the marketplace. Where the CIRR is not an adequate proxy for market rates – as it is not, as discussed above – then an alternative market benchmark must be used. Brazil is wrong in interpreting the Appellate Body's statement as authorizing Brazil to make the CIRR determinative of the existence of a material advantage. The Appellate Body was merely indicating that the CIRR constitutes evidence that is relevant to that consideration.

93. Third, Brazil's reference to a CIRR interest rate divorced from the terms and conditions on which that rate depends is untenable and contrary to the findings of the Appellate Body. While the Appellate Body has found that the CIRR is an appropriate "market benchmark" for determining whether "payments" within the first paragraph of Item (k) are used to secure a material advantage, it did so because the CIRR is the interest rate reference point under the OECD Arrangement.⁶⁵ As the Appellate Body explained:

⁶¹ *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), p. 212 ("benchmark"). (Exhibit CDA-18)

⁶² Korea – Dairy Safeguards, para. 80.

⁶³ Article 21.5 Appellate Body Report, para. 64.

⁶⁴ *Ibid.*

⁶⁵ Article 21.5 Appellate Body Report, para. 61, citing the Original Appellate Body Report, para. 181.

... the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are 'used to secure a material advantage in the field of export credit terms'.⁶⁶

94. The CIRR is an interest rate that has been constructed within the context of the OECD Arrangement. Under that Arrangement, the CIRR can only be offered when the other disciplines of the Arrangement are respected. As the Appellate Body noted:

... a participant in the *OECD Arrangement* can always offer borrowers officially-supported export credits if, besides respecting the CIRR, it also respects the other "repayment terms and conditions" of the *OECD Arrangement* (see Introduction, *OECD Arrangement*).⁶⁷

95. Thus, the CIRR is only reflective of the market by virtue of its application within the framework of the OECD Arrangement, which *requires* that participants respect, in addition to the CIRR, other repayment terms and conditions. The CIRR has meaning and relevance as a benchmark only when considered as part of this "package" of terms and conditions. As noted in the OECD Arrangement, this package includes minimum premium benchmarks, the minimum cash payments to be made (*i.e.* loan-to-asset value) and maximum repayment terms.⁶⁸ Unless these other terms and conditions are respected, the CIRR is not representative of any market and is not an "appropriate" benchmark.

96. It therefore is clear, that when the Appellate Body referred to the CIRR as a appropriate benchmark by which to assess whether payments are used to secure a material advantage in the field of export credit terms, it could not have been referring to the CIRR stripped of the other terms and conditions set out in the OECD Arrangement from which it is derived. As a matter of treaty interpretation, the other requirements of the OECD Arrangement are essential context for understanding the relevance of the CIRR as a "market benchmark".

97. Accordingly, simply by limiting interest rate buy-downs to the CIRR, Brazil cannot demonstrate that PROEX III does not secure a material advantage in the field of export credit terms.

VI. FINDINGS REQUESTED

98. For the foregoing reasons, Canada requests that the Panel find that conditional commitments as of 6 December 2000 to pay PROEX subsidies on the export of Brazilian regional aircraft pursuant to PROEX III are subsidies contingent upon export performance within the meaning of Article 3.1(a) of the SCM Agreement, and that Brazil has failed to implement measures that would bring the PROEX export subsidy program into compliance with the recommendations and rulings of the DSB and Articles 4.7 and 3.2 of the SCM Agreement.

99. Canada further requests that the Panel make detailed findings in respect of all three elements of Brazil's affirmative defence. Canada requests that the Panel find that:

- (a) there is no *a contrario* exception under Item (k) of Annex I to the SCM Agreement;
- (b) PROEX payments are not payments of the type covered by the first paragraph of Item (k); and

⁶⁶ Original Appellate Body Report, para. 181, also cited in the Article 21.5 Appellate Body Report, para. 61.

⁶⁷ Article 21.5 Appellate Body Report, para. 62, n. 68.

⁶⁸ OECD Arrangement, *supra* note 14, Introduction, p. 4.

- (c) PROEX payments are used to secure a material advantage in the field of export credit terms.

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- CDA-1. "Redefining the rules applicable to transactions under the interest rate equalization system of the Export Financing Program – PROEX," Central Bank of Brazil (BCB) Resolution No. 002799 (6 December 2000).
- CDA-2. "Establishing maximum percentages for the tax rate equalization system under the Export Financing Program – PROEX," Banco Central do Brasil Newsletter No. 002881, 19 November 1999.
- CDA-3. M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Econômico* (30 October 2000).
- CDA-4. Statement by Brazil: DSB Meeting of 12 December 2000: Agenda Item 3: *Brazil – Export Financing Programme for Aircraft*: Implementation of the recommendations of the DSB.
- CDA-5. OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998).
- CDA-6. Statement by Brazil: DSB Meeting of 16 February 2001: Agenda Item II: *Brazil – Export Financing Programme for Aircraft*.
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- CDA-9. G.G. Fitzmaurice, "The Law and Procedure of the International Court of Justice: Treaty Interpretation and Certain Other Treaty Points," (1951) 28 B.Y.I.L. 1.
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- CDA-12. *The New Shorter Oxford English Dictionary on Historical Principles*, v. 2 (Oxford: Clarendon Press, 1993), p. 2520 ("refer").
- CDA-13. *Oxford Thesaurus: An A-Z Dictionary of Synonyms* (Oxford: Clarendon Press, 1991), p. 384 ("refer").
- CDA-14. *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), pp. 1713-1714 ("material").
- CDA-15. *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 991 ("material").
- CDA-16. Affidavits from Tyrolean Airways (2 February 2000); Augsburg Airways (1 February 2000); Comair, Inc. (2 February 2000); and CIBC World Markets (2 February 2000).

- CDA-17. "EETC Market Update: Monthly Update: Airlines" (Morgan Stanley Dean Witter, Fixed Income Research, North America, Investment Grade Credit – Industrials) 10 February 2001.
- CDA-18. *The New Shorter Oxford English Dictionary on Historical Principles*, v. 1 (Oxford: Clarendon Press, 1993), p. 212 ("benchmark").

ANNEX A-2

REBUTTAL SUBMISSION BY CANADA

(23 March 2001)

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Note: Certain exhibits to this submission contain business confidential information, the disclosure of which to non-government persons including those directly or indirectly involved in the aircraft industry would prejudice private commercial interests. These exhibits have been designated "Confidential", in accordance with Article 18.2 of the DSU.

I. INTRODUCTION

1. In its 16 March 2001 First Submission, Brazil offers three main arguments in defence of its export subsidy practices. First, it asserts that PROEX III payments on exports of regional aircraft no longer constitute a subsidy within the meaning of Article 1 of the *Agreement on Subsidies and Countervailing Measures* (SCM Agreement). Second, it contends in the alternative that PROEX III payments, as subsidies, now comply with the interest rate provisions of the OECD's Arrangement on Guidelines for Officially Supported Export Credits (the "Arrangement")¹ and are therefore eligible for the "safe haven" of the second paragraph of Item (k) to Annex I of the SCM Agreement. Brazil also asserts that, although the version of the OECD Arrangement now in force dates from 1998, the relevant version for the purposes of the second paragraph of Item (k) should be the 1992 version. Third, Brazil argues in the further alternative that PROEX III payments are not used to secure a material advantage in the field of export credit terms and therefore qualify for an alleged *a contrario* exception under the first paragraph of Item (k).

2. Nowhere does Brazil describe in its First Submission how PROEX III is currently administered with respect to exports of regional aircraft. As Canada will demonstrate, it appears that in addition to the traditional method of administering PROEX (i.e. as interest rate buy-down payments on financing negotiated in the commercial market), PROEX III is now offered in conjunction with, or as part of, export financing packages provided by Brazil's development bank, the Banco Nacional de Desenvolvimento Económico e Social (BNDES). In addition, Brazilian export subsidies for regional aircraft may be completely subsumed in BNDES financing in such a way that the PROEX III payments are hidden. These latter approaches to the administration of PROEX provide a benefit that is no different from that provided under the traditional approach to administering PROEX I and II.

3. In this submission, Canada will demonstrate that, as a matter of fact and of law, each of Brazil's three defences for PROEX III must be rejected, whether PROEX is implemented as traditional interest rate buy-down payments or in conjunction with BNDES financing. As Canada will demonstrate, PROEX III financing support on exports of regional aircraft continue to amount to subsidies within the meaning of Article 1 of the SCM Agreement that are contingent upon export performance within the meaning of Article 3 of that Agreement.²

4. Brazil's first defence, that PROEX III support does not confer a "benefit" within the meaning of Article 1.1 of the SCM Agreement is without merit. Whether or not PROEX III support is consistent with the commercial interest reference rate ("CIRR") or the OECD Arrangement does not go to the legal question of whether a benefit is conferred. Thus, Brazil has not rebutted the *prima facie* case presented in Canada's First Submission, that PROEX III financing support continues to be a

¹ OECD, *The Arrangement on Guidelines for Officially Supported Export Credits* (Paris: OECD, 1998, 1992) [hereinafter "1998 OECD Arrangement" and "1992 OECD Arrangement" respectively]. Canada has filed the relevant sections of the 1998 OECD Arrangement as Exhibit CDA-5. Brazil has filed the 1998 OECD Arrangement as Exhibit Bra-9 and the 1992 OECD Arrangement as Exhibit Bra-7.

² In this submission, Canada uses the term "PROEX III financing support" or "PROEX III support" to encompass both the traditional PROEX payments and the other forms of support offered by Brazil as described in paragraph 2 of this submission.

prohibited export subsidy because it consists of cash payments to a recipient to buy down further the interest rate available to that recipient in the marketplace.³

5. Canada will also demonstrate that Brazil has not met its burden of proof with respect to the two affirmative defences it attempts to invoke. With respect to the second paragraph of Item (k), the legal argument and evidence put forward by Brazil does not establish compliance with either the 1998 or the 1992 versions of the OECD Arrangement. Rather, the evidence presented by both Brazil and Canada is to the contrary. As Brazil acknowledges, for financing support for regional aircraft to conform to the interest rate provisions of the OECD Arrangement, it must be limited to terms of no more than 10 years and to coverage not exceeding 85 percent of the value of the aircraft. Brazil has not established that PROEX III financing support is limited to these terms. On that basis alone, Brazil has not established that PROEX III can benefit from the "safe haven" of the second paragraph of Item (k). Nor has Brazil demonstrated compliance with the other requirements of the OECD Arrangement.

6. Canada will show that, contrary to Brazil's further assertion, the 1998 version of the OECD Arrangement is indeed the applicable one under the second paragraph of Item (k). However, irrespective of which version of the OECD Arrangement applies, PROEX III is not in compliance.

7. With respect to paragraph 1 of Item (k), Brazil's submission does not respond to the arguments set out in Canada's First Submission, let alone establish a *prima facie* case for the application of the alleged exception. In this submission, Canada highlights the legal and factual flaws in the limited arguments presented by Brazil.

II. PROEX III CONFERS A BENEFIT AND IS A SUBSIDY WITHIN THE MEANING OF ARTICLE 1 OF THE SCM AGREEMENT

8. Brazil's claim that PROEX III is not an export subsidy is based on its contention that PROEX III does not confer a "benefit". This contention is based on two arguments. First, Brazil argues that to the extent that PROEX III buys down to the CIRR interest rate, the payments do not confer a benefit.⁴ Second, Brazil argues that to the extent that PROEX III conforms more broadly to the interest rates provisions of the OECD arrangement, it does not confer a benefit.⁵

A. PROEX III CONFERS A BENEFIT EVEN IF IT COMPLIES WITH A CIRR OR THE OECD ARRANGEMENT

9. With respect to both arguments, Brazil is misconstruing the legal significance of compliance with the CIRR or the OECD Arrangement. Such compliance is legally relevant only to the extent that paragraph 2 of Item (k) or the alleged *a contrario* exception in paragraph 1 of Item (k) is invoked. Upon successful invocation, compliance does not mean that a benefit within the meaning of Article 1 has not been conferred. Rather, it means that the prohibitions in Article 3 of the SCM Agreement may not apply. As noted by the Arbitrators in the proceeding in this dispute under Article 22.6 of the DSU, the fact that an export subsidy is justified under Item (k) "does not mean that it is no longer a subsidy. It simply means that it is not a *prohibited* subsidy".⁶ [emphasis in the original]

10. Brazil's arguments at paragraphs 11 through 15 of its First Submission conflate the meaning of "benefit" in Article 1 of the SCM Agreement with the concepts of "material advantage" in

³ First Written Submission of Canada, 2 March 2001, paras. 9 and 73 [hereinafter "Canada's First Submission"].

⁴ First Submission of Brazil, 16 March 2001, para. 11 [hereinafter "Brazil's First Submission"].

⁵ *Id.*, para. 15.

⁶ *Brazil – Export Financing Programme for Aircraft: Recourse to Arbitration by Brazil under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement*, WT/DS46/ARB, adopted 12 December 2000, para. 3.39.

paragraph 1 of Item (k) and compliance with the OECD Arrangement in paragraph 2 of Item (k). All references by the Appellate Body to CIRR have been in the context of determining whether payments under PROEX I and II were used to "secure a material advantage".⁷ The Appellate Body has recognized that the meaning of "material advantage" in Item (k) is legally distinct from the existence of a "benefit" under Article 1.⁸ Brazil fails to recognize this critical distinction.

11. The applicable legal test for the existence of a "benefit" is set out in the Appellate Body Report in *Canada – Aircraft*.⁹ The Appellate Body found that a benefit is provided to a recipient where a financial contribution makes the recipient better off than it would otherwise have been absent that contribution.¹⁰ According to the Appellate Body:

the marketplace provides an appropriate basis for comparison in determining whether a "benefit" has been "conferred", because the trade-distorting potential of a "financial contribution" can be identified by determining whether the recipient has received a "financial contribution" on terms more favourable than those available to the recipient in the market.¹¹

12. As Canada noted in its First Submission, PROEX III, like its predecessor schemes, is constructed as a buy-down of interest rates that have already been freely negotiated by the recipients – Embraer's customers – in the marketplace.¹² Accordingly, any buy-down below those freely negotiated rates will necessarily result in net interest rates on terms more favourable than those available to Embraer's customers in the market. Thus, PROEX III, like its predecessor schemes, necessarily confers a benefit. If Embraer's customers could achieve financing in the marketplace at rates equivalent to those achieved by PROEX buy-downs, there would be no need for PROEX.

13. In the Article 22.6 proceeding in this dispute, Canada presented evidence that, contrary to Brazil's previous assertions, Brazil also offers direct financing for its regional aircraft through BNDES. Canada quoted from page 12 of Embraer's Preliminary Prospectus, which stated:

In addition to the PROEX program, we rely on the BNDES-exim program, also a government-sponsored financing program, to assist customers with financing. This program provides our customers with direct financing for Brazilian exports of goods and services. At March 31, 2000, approximately 51.1% of our backlog (in terms of value) was subject to financing by the BNDES-exim program.¹³

14. The same reasoning that applies to traditional PROEX buy-downs also applies to PROEX III payments that are administered in conjunction with BNDES financing or to BNDES financing that has completely subsumed PROEX III. It is apparent that the BNDES financing being offered in conjunction with PROEX III is being offered at the interest rate floor designated for PROEX III – *i.e.*,

⁷ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, adopted 4 August 2000, para. 61 [hereinafter "Article 21.5 Appellate Body Report"].

⁸ *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999, para. 179 [hereinafter "Original Appellate Body Report"].

⁹ *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999 [hereinafter "*Canada – Aircraft*, Appellate Body Report"].

¹⁰ *Id.*, para. 157.

¹¹ *Id.*; see also *United States – Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom*, Report of the Appellate Body, WT/DS138/AB/R, adopted 7 June 2000, paras. 67-68.

¹² Canada's First Submission, para. 73.

¹³ Canada's Answers to the Questions to the Parties, 24 July 2000, p. 11. The Prospectus uses a 57.5% figure at p. 77.

the CIRR.¹⁴ To the extent that PROEX III allows for the buy-down of BNDES financing to this level, or that BNDES is subsuming and offering PROEX financing support, Embraer customers are receiving financing at rates that would not be achievable either in the commercial market or from BNDES in the absence of PROEX III support.

15. Thus, PROEX III financial contributions confer a "benefit" under Article 1 of the SCM Agreement. They are therefore a subsidy. Brazil has not disputed that PROEX III is also contingent on export performance. Accordingly, PROEX III is a prohibited export subsidy within the meaning of Article 3 of the SCM Agreement. The burden lies with Brazil to prove that PROEX III support meets the conditions of the safe haven in the second paragraph of Item (k) or the alleged exception in the first paragraph (as well as to demonstrate that such an exception exists at all). It cannot do so.

B. EVEN AT CIRR, PROEX III CONFERS A BENEFIT

16. At paragraphs 11-14 of its First Submission, Brazil argues that the CIRR is representative of market rates and sometimes is above prevailing market rates. In certain circumstances Brazil may be correct. However, this observation in no way establishes that PROEX III financing support does not confer a benefit.

17. Canada has already explained why PROEX III, by its very design, confers a benefit. Even if this were not the case, PROEX III does not avoid conferring a benefit by establishing the CIRR as an interest rate floor. Canada demonstrated in its First Submission that the CIRR alone, divorced from the other terms and conditions of the OECD Arrangement such as the ten-year term limit and the limit on financing to 85 percent of the value of the contract, in no way reflects market realities.¹⁵ Brazil has not rebutted Canada's evidence and submissions on this point. Moreover, at paragraphs 87 to 90 of this Submission Canada demonstrates that, under current market circumstances, the CIRR is substantially below the commercial interest rates available to regional airlines for the purchase or lease of regional aircraft.

III. BRAZIL'S REVISED POSITION ON PARAGRAPH 2 OF ITEM (K) OF THE ILLUSTRATIVE LIST

18. In its First Submission, Brazil substantially revises its position on paragraph 2 of Item (k) of the Illustrative List. Brazil did not invoke the second paragraph of Item (k) in the PROEX I proceeding because, in its own words to the Appellate Body "it 'has concluded that conformity to the OECD provisions is too expensive'".¹⁶ It was silent on the second paragraph of Item (k) in the PROEX II proceeding. Brazil now claims that it "has complied with Canada's stated wishes and conformed PROEX to the interest rate provisions of the *Arrangement*, as required by the second paragraph of Item (k)" and goes so far as to suggest in the conclusion of its First Submission that "[t]he sole issue before this Panel is whether the regulations governing PROEX conform to the relevant provisions of the *Arrangement*".¹⁷

19. Had Brazil actually brought its export subsidy practices into conformity with the relevant provisions of the OECD Arrangement as it now claims, this long-standing dispute would have been largely resolved. Unfortunately, as described in this section, there are strong reasons to doubt Brazil's

¹⁴ Declaration of Ian Darnley, dated 21 March 2001 [hereinafter "Darnley Declaration"]. (Confidential Exhibit CDA-19)

¹⁵ Canada's First Submission, paras. 77-83 and 94-95.

¹⁶ Original Appellate Body Report, para. 180.

¹⁷ Brazil's First Submission, para. 72.

claim. Moreover, because Brazil's claim is in the nature of an affirmative defence, Brazil bears the burden of proof.¹⁸

A. BRAZIL'S POSITION IS CONTRARY TO ITS PUBLIC STATEMENTS

20. Other than in its First Submission, Brazil has never once contended that it had conformed its measures to the OECD Arrangement, or that it would do so in the future. On the contrary, it has consistently maintained that it would not do so. Brazil has insisted that it will not abide by the provisions of the OECD Arrangement in public statements by its officials, in its statements to the DSB and in every one of the six consultation and negotiation sessions that Canada and Brazil have held since the release of the original *Brazil – Aircraft* Article 21.5 Panel Report in May 2000.¹⁹

21. Thus, for example, as reported in the 31 August 2000 edition of the daily *Correio Braziliense*, Brazil's chief negotiator in this dispute, Ambassador José Alfredo GraHa Lima, described Brazil's position as follows:

"We will only change the interest rates, for this was determined by WTO regulations." ... "However, we have no obligation before the WTO to change other aspects such as terms and the coverage of lending. This will not be done. That is the government's position."²⁰

22. Later, when, in an effort to reach a negotiated settlement, Canada met with Brazil in Rio de Janeiro on 28 and 29 November 2000, just days before Brazil's PROEX III measures came into force, Brazil again refused to consider adjusting the PROEX scheme so as to abide by the interest rate provisions of the OECD Arrangement.

23. In fact, Brazil never did make the changes it now claims to have made. On 7 December 2000, the day after the relevant amendments to PROEX took effect, *Valor Económico*, Brazil's national daily business newspaper reported:

However, resolution 2.799 from the Central Bank, which set the new rules, follows very closely the Brazilian interpretation of the final decision by the WTO dispute resolution system. This fact raises doubts about a possible Canadian retreat. That is to say, the text changes only equalization conditions, so that the final interest rate of financing should not be set below CIRR, which is set on a monthly basis by the OECD. Until December 14th, this rate will be set at 6.84%.

The broader requests presented by Canada during negotiations were discarded. The Canadian government requested that the financing terms of Embraer's sales be limited to ten years and that equalization covered up to 85% of the amount financed.²¹

24. In January 2001, when Canada requested this Article 21.5 proceeding, Brazil's *Gazeta Mercantil* reported:

The new PROEX takes as a reference for interest equalization the CIRR, (OECD's basic rate), whereas beforehand the reference was Libor plus 0.2%. With the

¹⁸ See Article 21.5 Appellate Body Report, para. 66; *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted 23 May 1997, p. 16.

¹⁹ These consultations took place in May 2000, in New York; in June 2000, in Geneva; in July 2000 in Montreal; in August 2000 in Sao Paulo; in September 2000 in New York and in November 2000, in Rio de Janeiro.

²⁰ "Tough Agreement with Canada," *Correio Braziliense* (31 August 2000). (Exhibit CDA-20)

²¹ D.C. Marin, "Government changes PROEX interest rates," *Valor Económico* (7 December 2000). (Exhibit CDA-21)

adjustment, rates will never be set below CIRR. The Brazilian position is that this eliminates export subsidisation. Ottawa, however, says that the program will only be compatible with the rules if it reduces financing from 15 to 10 years and places a limit of 85% of the amount of sales, instead of the current 100% coverage. "These are OECD rules, and we are not going to accept them," Brazilian authorities reacted.²²

25. Similarly, at neither of the DSB meetings at which Canada requested this Article 21.5 proceeding did Brazil state that it had conformed its measures to the OECD Arrangement. Instead, it claimed that it could comply by limiting its interest rate buy-downs to the CIRR alone. It then complained that Canada's position "would require Brazil to strictly adhere to OECD Consensus regulations that would severely and unfairly tilt the playing field against the Brazilian exporter".²³

26. The question therefore, is not, as Brazil would have it, why Canada has again sought recourse to this Article 21.5 proceeding. The real question is why Brazil has until its First Submission been so reluctant to admit to a course of action that, if actually taken by 6 December as it now claims, would have largely resolved this dispute. The answer is that despite its claims, Brazil has not changed PROEX to comply with the OECD Arrangement. This conclusion is further supported by the statement of Brazil's own Foreign Minister Lampreia that: "For us, the interest rate is the OECD rate, the coverage is 100% and there are no limits on the length of terms."²⁴

B. BRAZIL HAS ALREADY BEEN FOUND TO WAIVE ITS PROEX "REQUIREMENTS"

27. The second reason to doubt Brazil's claim that PROEX III conforms to the interest rate provisions of the OECD Arrangement is that Brazil has previously been found to waive the requirements that it now contends limit the terms of the financing it can offer. Brazil now claims that the maximum length of the financing term under PROEX III is 10 years, as required by Article 21 of Annex IV to the OECD Arrangement.²⁵ Brazil relies for this claim on the Central Bank of Brazil (BCB) Circular 2881 of 19 November 1999 and the 21 December 1999 Directive 374 of the Ministry of Development, Industry and Foreign Trade.

28. However, Brazil made the same claim on the basis of the same documents in the original Article 21.5 proceeding. That claim has already been rejected. Thus, in its 14 February 2000 response to Question 6 from this Panel in the original Article 21.5 proceeding Brazil acknowledged that, notwithstanding Circular Letter 2881, the 10-year term "was waived, and continues to be waived, however, for regional jet aircraft."

29. Accordingly, as Canada noted in its First Submission, this Panel found that, despite Circular 2881, the Committee on Export Credits, which administers PROEX:

... has the authority to waive some of the published PROEX guidelines. In the case of regional aircraft, the most frequent waiver has been to extend the length of the financing term from ten to fifteen years.²⁶

30. Similarly, Brazil claims that it conforms with Article 3 of the OECD Arrangement, which restricts export financing to 85 percent of the value of the export contract.²⁷ Brazil bases this claim on

²² A. Moreira and F. Paraguassu, "Canada requests condemnation of the new PROEX in the WTO," *Gazeta Mercantil* (20 January 2001). (Exhibit CDA-22)

²³ Statement by Brazil: DSB Meeting of 01 February 2001: Agenda Item 7. (Exhibit CDA-23)

²⁴ M.L. Abbott, "Bombardier's partnership in the country does not change negotiations with Canada" *Valor Econômico* (30 October 2000). (Exhibit CDA-3)

²⁵ Brazil's First Submission, para. 47. Brazil refers to the 1992 version of the Arrangement. Article 21 is found in Annex III to the 1998 version.

²⁶ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000, para. 2.4 [hereinafter "Article 21.5 Panel Report"].

Article 5 of Directive 374.²⁸ However, Directive 374, which dates from 21 December 1999, is clearly not a measure taken to revise PROEX in the light of the recommendations and rulings of the DSB stemming from the original Article 21.5 proceedings. Not only does it predate those recommendations and rulings, but, as already noted, it applied to PROEX II.

31. Minister Lampreia's statement, previously cited, also appears to confirm that the Committee's waivers, both as to the term of financing and the percentage of the contract value financed, have continued since 1999 and to the present day.

C. PROEX III FINANCING SUPPORT OFFERED BY BRAZIL DEPARTS FROM THE OECD ARRANGEMENT

32. The third reason for doubting Brazil's claim of conformity with the interest rate provisions of the OECD Arrangement is the available evidence of the export financing for regional aircraft that has been offered by Brazil and that would be covered under PROEX III.

33. In recent negotiations to sell regional jet aircraft to Air Wisconsin Airlines Corporation, Embraer offered financing through BNDES at a rate equivalent to the CIRR.²⁹ Although Brazil's initial offer predated the changes to PROEX, negotiations by Bombardier and Embraer continued past 6 December 2000. Accordingly, had Air Wisconsin accepted Embraer's offer, the financing support would have been governed by the 6 December 2000 changes to PROEX.

34. In response to Brazil's offer of financing support to Air Wisconsin, Canada, through its Export Development Corporation, proposed a comparable financing package for Air Wisconsin to acquire Bombardier regional jets. The Bombardier financing would have a term of 16.5 years, an interest rate equivalent to the CIRR and would cover up to 78 percent of the aircraft purchase price. As described in Exhibit CDA-24, Air Wisconsin has confirmed that the financing proposed by Bombardier is no more favourable than that offered by Embraer.³⁰ Although Air Wisconsin indicates in CDA-24 that it cannot offer further details due to confidentiality commitments to Embraer, the only reasonable inference that can be drawn from Air Wisconsin's statement is that the financing offered by Brazil through Embraer, is at, or very close to, a 16.5 year term.

35. Similarly, Fairchild Dornier, an aircraft manufacturer, has received information that in November 2000 during negotiations for a sale of regional jets to a South African airline, SA Airlink Embraer offered PROEX financing support for a period of 15 years.³¹ Embraer announced that sale on 14 December 2000, one week after the modifications made to PROEX in Resolution 2799.³² Fairchild Dornier's information is substantially corroborated by the report from a Bombardier sales executive, submitted as Confidential Exhibit CDA-XX.³³

36. On the basis of all of the available evidence, it appears that either PROEX III itself does not conform to the interest rate provisions of the OECD Arrangement, or that Brazil is using another

²⁷ Again, this is the 1992 version of the OECD Arrangement. The same requirement is found in Article 7 of the 1998 version.

²⁸ Brazil's First Submission, para. 42.

²⁹ Darnley Declaration. (Confidential Exhibit CDA-19)

³⁰ Letter from W.P. Jordan, Executive Vice President, Administration and General Counsel, United Express, operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001. (Exhibit CDA-24)

³¹ Letter from Fairchild Dornier, dated 22 March 2001. (Confidential Exhibit CDA-25)

³² "SA Airlink Selects the ERJ 135 and Purchases 70 Units," Embraer Press Release, 14 December 2000, available on the Embraer website at <http://www.embraer.com/english/imprensa/index.htm>. (Exhibit CDA-26)

³³ Declaration of Hormuzd Irani, dated 21 March 2001. (Confidential Exhibit CDA-27)

export subsidy mechanism, apart from or in conjunction with PROEX, to offer regional aircraft financing on terms that depart from the OECD Arrangement.

37. In the light of the foregoing evidence, Brazil has failed to meet its burden of proving that it is in conformity with the interest rate provisions of the OECD Arrangement. If, however, this Panel chooses to seek additional information from Brazil, Canada asks that the Panel request from Brazil the specific terms of its offers of export financing for transactions involving Embraer regional aircraft in the months leading up to and following the 6 December 2000 revisions to the PROEX program. The relevant information would include the percentage of the interest rate buy-down, the resulting net interest rate, the term of the financing and percentage of the value of the aircraft covered by the financing and whether the financing has been offered under PROEX alone or in conjunction with BNDES.

38. If the Panel seeks this information and Brazil does not provide it, Canada asks that the Panel infer that the measures under which Brazil continues to offer export subsidies for regional aircraft do not qualify for the "safe haven" under the second paragraph of Item (k) and that accordingly, Brazil has failed to bring its measures into conformity with the recommendations and rulings of the DSB and with Article 3.1(a) and 3.2 of the SCM Agreement.³⁴

IV. BRAZIL HAS OTHERWISE FAILED TO SHOW THAT PROEX MEETS THE REQUIREMENTS OF THE SECOND PARAGRAPH OF ITEM (K)

39. In its First Submission, Brazil appears to place its greatest faith in its second principal argument: that PROEX III qualifies for the "safe haven" in the second paragraph of Item (k) because Brazil has revised its PROEX III practices to bring them into conformity with the OECD Arrangement.

40. Brazil contends that, although PROEX III is a prohibited subsidy, it nevertheless meets the conditions of the second paragraph of Item (k) in Annex I of the SCM Agreement. Brazil further contends that the 1992 version of the OECD Arrangement – instead of the 1998 version – should be used as the yardstick to judge its alleged "conformity" with the "interest rates provisions" as specified in the Item (k), second paragraph, exception.

41. As Canada has already demonstrated, Brazil's measures do not conform to two of the key requirements of the OECD Arrangement: that export subsidies be limited to terms of ten years and that financing cover no more than 85 percent of the value of the goods financed. As these requirements are common to both the 1992 and the 1998 versions of the OECD Arrangement, Brazil's measures do not conform to the OECD Arrangement regardless of whether the 1998 version or the 1992 version is relevant for the purposes of the Item (k), second paragraph, exception.

42. Nevertheless, in the following sections, Canada will demonstrate in detail why PROEX III is not in conformity with the other "interest rates provisions" of either the 1998 or the 1992 versions of the OECD Arrangement. Although the issue is moot in this proceeding, Canada will also demonstrate that the 1998 Arrangement is the relevant one for the purposes of the exception in Item (k), second paragraph.

A. PROEX III IS NOT IN CONFORMITY WITH THE INTEREST RATE PROVISIONS OF THE 1998 OECD ARRANGEMENT

43. To meet the conditions of the Item (k), second paragraph exception, Brazil must prove that its measures conform to every element of the exception. The Article 21.5 Panel in the *Canada - Aircraft*

³⁴ The authority of a panel to draw adverse inferences has been recognized by the Appellate Body in *Canada - Aircraft*, Appellate Body Report, paras. 202-03.

dispute,³⁵ after a thorough analysis, defined what it means to be "in conformity with" the "interest rates provisions" of the Arrangement, and therefore what is required to claim the exception. Although "interest rate provisions" arguably has a broader meaning than that given to it by the Panel in *Canada – Aircraft*, at a minimum, the interest rate provisions to which PROEX III must conform are those identified by the *Canada - Aircraft* Panel, namely the "applicable provisions of Articles 7-10 and 12-26 of the Arrangement; and of Articles 18-24 and Articles 27-29(a)-(c) of Annex III".³⁶

44. PROEX III fails to meet each and every requirement. Thus, Brazil cannot claim the exception. Moreover, even if the "interest rates provisions" were limited to those identified by Brazil,³⁷ PROEX III fails to meet those provisions. Accordingly, Brazil's claim to the exception in Item (k), second paragraph, must fail.

45. Brazil claims that PROEX III is "in conformity with" *all* of the "interest rates provisions" in the OECD Arrangement, as defined by the Article 21.5 Panel in *Canada - Aircraft*.³⁸ However, Brazil offers no evidence to support its claim other than Resolution 2799 itself. Nor does its argument even mention most of the interest rate provisions in the Arrangement. Brazil mentions Articles 7 and 15 of the main text of the Arrangement and Articles 21, 22 and 29(a) of Annex III.³⁹ It completely disregards Articles 8, 9, 12-14 and 16-26 of the main text and Articles 18-20, 23, 24, 27-28 and 29(b) and (c) of Annex III.

46. Certain of these provisions are very significant and affect the very structure of the transaction, e.g., Article 13 entitled Repayment of Principal requires the "principal sum" to "be repaid in equal and regular instalments". This is not the same as a normal amortization where, although the payment amount stays the same, the principal and interest portions vary over the life of the repayment schedule. Article 13 requires the principal portion of each payment to be the same over the life of the repayment schedule. This provision eliminates balloon payments – a common tool used to make financing proposals more attractive.

47. Another provision of importance is Article 29(a)-(c) of Annex III on spare parts. Contrary to Brazil's claim, spare parts often comprise a significant portion of any given transaction.⁴⁰ Article 6 of Directive 374 allows for financing of up to 20 percent for spare parts,⁴¹ whereas Article 29(a) of the Arrangement limits financing for spare parts to a maximum of 15 percent of the aircraft price for the first five aircraft and to 10 percent for the sixth and subsequent aircraft. Thus, the limit in Directive 374 explicitly exceeds that in the OECD Arrangement. Moreover, Brazil regularly uses its discretion to waive the limits on PROEX.

48. Even using Brazil's own interpretation of the "interest rates provisions",⁴² Brazil offers no evidence of conformity with Articles 16-19 of the main text. Therefore, PROEX III is not "in conformity with" the "interest rates provisions" of the 1998 Arrangement. Its claim to the exception in Item (k), second paragraph, must fail.

³⁵ *Canada – Measures Affecting the Export of Civilian Aircraft: Recourse by Brazil to Article 21.5 of the DSU*, Report of the Panel, WT/DS70/RW, adopted 4 August 2000, [hereinafter "*Canada – Aircraft*, Article 21.5 Panel Report"].

³⁶ See *id.*, para. 5.147.

³⁷ 1998 OECD Arrangement, *supra* note 1, Articles 15-19 and Annex III, Article 22 as listed in Brazil's First Submission, para. 52.

³⁸ Brazil's First Submission, para. 53.

³⁹ *Id.*, paras. 54-59.

⁴⁰ Declaration of George Stevens, dated 20 March 2001, pp. 3 and 4. (Confidential Exhibit CDA-28)

⁴¹ Brazil's First Submission, para. 60.

⁴² *Id.*, para 52.

B. PROEX III IS NOT IN CONFORMITY WITH THE INTEREST RATE PROVISIONS OF THE 1992 OECD ARRANGEMENT

49. Even if the 1992 Arrangement is used, PROEX III fails to meet the conditions of the exception in Item (k), second paragraph. Comparing the 1992 Arrangement to the findings of the Canada 21.5 Panel results in the following 1992 Arrangement provisions: Articles 3-7 of the main text, Articles 9, 17-22, 24 and 25 of Annex IV, and several definitions in Annex V. The 1992 Arrangement has no counterparts for the 1998 Arrangement's Articles 18-24 of the main text and Articles 27 (portions on used aircraft and service contracts), 28 and 29(b) and (c) in Annex III.

50. As Canada has already demonstrated, PROEX III does not conform to two of the key requirements of both the 1998 and 1992 versions of the Arrangement: that export subsidies be limited to terms of ten years and that financing cover no more than 85 percent of the value of the goods financed. This non-conformity in 1992 Arrangement terms corresponds to Article 21 of Annex IV and Article 3 of the main text, respectively. Thus, even using Brazil's limited definition of "interest rates provisions", i.e., Article 5 of the main text and Article 21 of Annex IV,⁴³ PROEX III is not "in conformity with" the "interest rates provisions" of the 1992 Arrangement.

51. Once again, besides a bald assertion that "PROEX III conforms with the corresponding interest rates provisions",⁴⁴ Brazil provides no evidence of conformity other than Resolution 2799. As previously noted, however, the nominal limitations in Resolution 2799 are the same as have been examined in every WTO proceeding in this dispute. Those nominal limitations have no meaning since Brazil demonstrably has the authority and continually uses the authority to waive these limits on terms and amounts financed. There is nothing to suggest that the waivers are not continuing under PROEX III.

52. Therefore, PROEX III is not "in conformity with" the "interest rates provisions" of the 1992 Arrangement. Its claim to the exception in Item (k), second paragraph, must fail.

C. THE 1998 VERSION OF THE OECD ARRANGEMENT, NOT THE 1992 VERSION, IS RELEVANT FOR THE PURPOSES OF THE SECOND PARAGRAPH OF ITEM (K)

53. Brazil's claim that the 1992 version of the OECD Arrangement is the relevant one relies on a textual interpretation of the exception in Item (k), second paragraph, that is untenable. The starting point for interpreting the exception in Item (k), second paragraph, is the general rule of interpretation in Article 31 of the *Vienna Convention on the Law of Treaties* (the "Vienna Convention").⁴⁵

⁴³ *Id.*, para. 40.

⁴⁴ *Id.*

⁴⁵ *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, pp. 16-17. Article 3.2 of the WTO's *Understanding on the Rules and Procedures Governing the Settlement of Disputes* (DSU) requires WTO Agreements (including the SCM Agreement) to be interpreted in accordance with "customary rules of interpretation of public international law". These rules are set out in the Vienna Convention. ...Article 31 of the Vienna Convention reads as follows:

Article 31

General rule of interpretation

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

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;

54. According to the general rule, treaty interpretation begins with a careful reading of the text. Treaty terms must be given their ordinary meaning unless the text indicates that a term is intended to have a special meaning. The ordinary meaning of a term is determined in the context of the treaty and in the light of the treaty's object and purpose. Given that Item (k), second paragraph, creates an exception to the SCM Agreement, it must be interpreted in the context of the SCM Agreement.

1. Brazil's Interpretation Rewrites The Item (k) Exception

55. The exception in Item (k), second paragraph, reads as follows:

Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

56. The text at issue is "successor undertaking which has been adopted by those original Members". Brazil's argument relies on the phrase "has been". Using Brazil's logic, the text "has been" focuses on the past – i.e., 1 January 1995 – not the "time regarded as present".⁴⁶

57. In its ordinary meaning, the phrase "has been" will always be in the present perfect tense because, e.g., an agreement or resolution, must be adopted – in the present – before it can take effect. The phrase requires a determination, at the time of the consideration of the application of Item (k) to a specific set of fact, whether there is a successor arrangement which "has", in the present, "been adopted."

58. This interpretation is confirmed by the context of the term "has been." For instance, under Brazil's approach, the phrase "if a Member is a party to an international undertaking" in Item (k) would only apply to Members who were parties to the OECD Arrangement as of 1 January 1995, excluding Members such as the Republic of Korea who have become parties since then. Simply stated, the Panel must determine whether a successor undertaking currently "has been adopted", not whether a successor undertaking *had* been adopted as of 1 January 1995.

59. Furthermore, the 1998 Arrangement is clearly a "successor undertaking" to the 1979 Arrangement. In its ordinary meaning, "successor" modifies "undertaking" and refers to "a ... thing which succeeds another in ... function"⁴⁷ or "one who replaces or follows another".⁴⁸ It is forward looking. The 1998 Arrangement "succeeds ... in ... function" and "replace[d]" the 1992 Arrangement, which in turn succeeded the 1979 Arrangement.

60. Moreover, Brazil's argument would lead one to believe that it was the entire original Membership of the WTO that adopted the 1992 Arrangement as of 1 January 1995. However, the text does not state this. The text refers to a: "successor undertaking which has been adopted by those *original* Members" (emphasis added). The word "original" is important because it links back to the

(b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

[...]

4. A special meaning shall be given to a term if it is established that the parties so intended.

⁴⁶ See Brazil's First Submission, para. 20.

⁴⁷ *The New Shorter Oxford English Dictionary on Historical Principles*, v. 2 (Oxford: Clarendon Press, 1993), p. 3128 ("successor"). (Exhibit CDA-29)

⁴⁸ *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 1446 ("successor"). (Exhibit CDA-30)

"twelve original Members" earlier in the text. The linkage makes it clear that "those original Members" are the "twelve original Members" that were parties to an international undertaking, i.e., the OECD Arrangement, as of 1 January 1979. The text "adopted by those original Members" refers to Members that are also parties to the OECD Arrangement – not the entire original Membership of the WTO. It is only the Members that are parties to the OECD Arrangement that could adopt a successor undertaking of the Arrangement. The text recognizes this fact. This further reinforces that the ordinary meaning of the text refers to the 1998 Arrangement.

61. Brazil's quotation of the exception in Item (k), second paragraph, in paragraph 17 of its First Submission omits the word "original" from the text of "those original Members". Without the word "original", "those Members" could be referring to "Members to this Agreement" which is what Brazil would lead the Panel to believe. At a minimum, this omission – in conjunction with its argument implying that the word "original" refers to the entire original WTO Membership⁴⁹ – is misleading.

62. In addition, the text at issue should be understood as a reference to an evolving system of disciplines on officially supported export credits. As the drafters were no doubt aware, the OECD Arrangement is not static or frozen in time. It has developed since its inception and continues to do so.⁵⁰ This process of development had occurred many times before 1 January 1995, e.g., in 1987, 1991 and 1994.⁵¹ The drafters could hardly have been unaware of such developments prior to 1 January 1995 when they drafted the language "successor undertaking which has been adopted by those original Members". On the contrary, the text specifically contemplates on-going evolution.

63. Finally, the text of the exception in Item (k), second paragraph, in the Illustrative List, tracks the text of the 1979 GATT Subsidies Code (the "GATT text"). The GATT text states:

Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least twelve original signatories to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.⁵²

64. Since the original OECD Arrangement was formed in 1978⁵³ – and no changes were made until 1981⁵⁴ – language that refers to a "successor undertaking" in 1979 must necessarily be forward looking. Brazil's retrospective interpretation does not reconcile with the 1979 GATT text because, in 1979, there was no "successor undertaking" to the 1978 Arrangement. Under Brazil's approach, the term "successor undertaking" in the 1979 GATT text would have no meaning. Thus, the 1979 GATT text supports the forward-looking interpretation of "successor undertaking" in the exception of Item (k), second paragraph, and provides further evidence that the drafters provided for the on-going evolution of the OECD Arrangement.

⁴⁹ Brazil, in paras. 20-22 of its First Submission, creates the implication by not using the word "those" in its argument when it uses the phrase "adopted by the original Members". The text reads "adopted by those original Members". See Item (k), second paragraph, of Annex I of the SCM Agreement [emphasis added].

⁵⁰ The OECD Arrangement was created in 1978. See *The Export Credit Arrangement: Achievements and Challenges 1978-1998* (Paris: OECD, 1998), pp. 9 and 20-21 [hereinafter *The Export Credit Arrangement*]. (Exhibit CDA-31)

⁵¹ See *id.*, pp. 18-20.

⁵² See "Illustrative List of Export Subsidies," Annex I to the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade ("the Subsidies Code") in *The Texts of the Tokyo Round Agreements* (Geneva: GATT, August 1996). (Exhibit CDA-32)

⁵³ See *The Export Credit Arrangement*, *supra* note 50, p. 9.

⁵⁴ See *The Export Credit Arrangement: Achievements and Challenges 1978-1998* (Paris: OECD, 1998), p. 24. (Exhibit CDA-33)

65. Accordingly, the ordinary meaning of the text "successor undertaking which has been adopted by those original Members" is the most recent version that has been adopted by the OECD, i.e., the 1998 Arrangement.

2. The Drafters Could Have Referred To The 1992 Arrangement But Did Not

66. The *Marrakesh Agreement Establishing the World Trade Organization* (the "WTO Agreement") took effect on 1 January 1995, three years after the 1992 version of the Arrangement. If the drafters intended the 1992 Arrangement to apply, they simply could have said so. Instead, the drafters crafted the exception in Item (k), second paragraph, to ensure that all Members knew that the exception was not frozen in time. As Canada has shown, the text specifically contemplates that the Arrangement will evolve.

3. The *Canada-Aircraft* Article 21.5 Panel Used The 1998 Arrangement In Its Analysis Of The Exception In Item (k) Second Paragraph

67. Although Brazil did not argue the relevance of a particular version of the OECD Arrangement in the Article 21.5 proceeding in *Canada – Aircraft*, the Panel in that proceeding conducted a thorough analysis of the exception in Item (k), second paragraph, using the 1998 version of the Arrangement. The Panel was of the view that the text "successor undertaking" meant that the Arrangement had evolved and that it could evolve further. The Panel made numerous references to "successor undertakings" including past and future changes to the Arrangement.⁵⁵ Brazil did not challenge the Panel's interpretation in the Article 21.5 proceeding.

V. PROEX III DOES NOT QUALIFY FOR AN ALLEGED A *CONTRARIO* EXCEPTION UNDER THE FIRST PARAGRAPH OF ITEM (K)

68. In order to succeed in its alleged defence under paragraph 1 of Item (k) of the Illustrative List, Brazil must at a minimum present a *prima facie* case with respect to each element of its alleged defence. It has not done so.

A. ITEM (K) FIRST PARAGRAPH DOES NOT GIVE RISE TO AN A *CONTRARIO* INTERPRETATION

69. Brazil has failed to present a *prima facie* case with respect to the first element of its alleged exception – i.e., that an alleged *a contrario* exception exists in the first paragraph of Item (k). Brazil simply asserts without legal authority that an *a contrario* interpretation of the first paragraph of Item (k) is "required" and that the failure to permit an *a contrario* interpretation "effectively would render the material advantage clause inutile, contrary to the customary rules of interpretation of public international law."⁵⁶

70. Brazil also notes in paragraph 66 of its submission that the Appellate Body "appears to take the view" that the first paragraph of Item (k) should be read *a contrario* to permit a subsidy that does not confer a material advantage. Nowhere does Brazil respond to Canada's arguments that the first paragraph of Item (k) does not give rise to such an *a contrario* interpretation.⁵⁷

71. This Panel addressed Brazil's first assertion in the original Article 21.5 proceeding. It found that the first paragraph of Item (k) allows for the identification of certain export credits and payments that are considered *per se* prohibited export subsidies, and for which an independent showing of

⁵⁵ *Canada – Aircraft*, Article 21.5 Panel Report, note 69, note 71, para. 5.85, note 85, and note 91.

⁵⁶ Brazil's First Submission, para. 65.

⁵⁷ Canada's First Submission, paras. 29-61.

subsidy and export contingency is, therefore, not necessary.⁵⁸ It properly found that such an interpretation did not render the first paragraph of Item (k) ineffective.⁵⁹

72. With respect to Brazil's reference to the *obiter dictum* of the Appellate Body, as discussed in Canada's First Submission, the statement was made without interpreting footnote 5.⁶⁰ In Canada's view, it is impossible to reach a conclusion as to the existence of an *a contrario* exception in the first paragraph of Item (k) without interpreting the language of footnote 5.⁶¹ Brazil fails to explain how, applying the relevant principles of treaty interpretation to Article 3.1, footnote 5 and the Illustrative List, a measure impliedly excluded from the illustrations (i.e., not referred to) in Annex I can be a measure "referred to in Annex I as not constituting an export subsidy".

73. Footnote 5 excludes the possibility of implied exceptions to the prohibition on export subsidies. Footnote 5 makes it clear that the only exceptions to Article 3.1 are those measures referred to as not constituting export subsidies in Annex I. Brazil's argument is based on the absence of reference to export credits or payments that do not confer a material advantage in the first paragraph of Item (k). Clearly, a thing cannot be referred to by failing to refer to it. There is simply no way to treat the absence of reference to a measure as a reference to that measure.

74. Accordingly, Brazil's position on the *a contrario* interpretation of the first paragraph of Item (k) is without merit.

B. PROEX III PAYMENTS ARE NOT PAYMENTS OF THE COSTS INCURRED IN OBTAINING CREDITS

75. In order to discharge its burden to establish that PROEX III support is the "payment ... of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the first paragraph of Item (k), Brazil reverts to arguments it presented to the Panel in the original 21.5 proceeding.⁶² However, Brazil's arguments have already been rejected by the Panel in that proceeding.

76. Brazil has offered no new arguments sufficient to establish that payments under PROEX III constitute the type of payment contemplated by the first paragraph of Item (k). Nor has it offered any arguments that would call into question the Panel's interpretation of the "payment" clause or its finding that PROEX payments are not payments of the costs incurred by exporters or financial institutions in obtaining credits, within the meaning of the clause.

77. Having failed to establish that PROEX III support is of the type covered by the first paragraph of Item (k), Brazil has failed to establish that PROEX III would qualify for its alleged *a contrario* exception under Item (k) first paragraph even if such an exception existed.

C. PROEX III SUPPORT IS USED TO SECURE A MATERIAL ADVANTAGE

78. Even if a proper interpretation of Item (k) did allow for Brazil's alleged *a contrario* exception and even if support under PROEX III did amount to the "payment ... of all or part of the costs incurred by exporters or financial institutions in obtaining credits", Brazil has not presented a *prima facie* case that PROEX III is not "used to secure a material advantage in the field of export credit terms".

⁵⁸ Article 21.5 Panel Report, para. 6.42.

⁵⁹ *Id.*

⁶⁰ Canada's First Submission, para. 49.

⁶¹ *Id.*, para. 50.

⁶² Brazil's First Submission, paras. 67-71.

79. In its First Submission, Brazil does not respond to the detailed argument presented by Canada in its First Submission.⁶³ Brazil simply cites the statement of the Appellate Body that "to establish that PROEX payments are not used to secure a material advantage, Brazil must prove *either* that the net interest rates under the revised PROEX are at or above the relevant CIRR ... *or*, that an alternative market benchmark is appropriate" [emphasis in original].⁶⁴ Brazil then contends that since PROEX III stipulates that the net interest rates must be at or above the relevant CIRR, no material advantage is being provided.⁶⁵

80. Brazil's argument ignores an important qualification established by the Appellate Body, namely that CIRR may not always accurately reflect the marketplace and therefore cannot be conclusive evidence of the absence of material advantage. The Appellate Body stated:

The CIRR is a constructed interest rate for a particular currency, at a particular time, that does not always necessarily reflect the actual state of the credit markets. Where the CIRR does not, in fact, reflect the rates available in the marketplace, we believe that a Member should be able, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions. Thus, the CIRR is not, necessarily, the *sole* "market benchmark" that may be used to determine whether a payment "is used to secure a material advantage in the field of export credit terms", within the meaning of Item (k) of the Illustrative List.⁶⁶ [emphasis in original]

81. As set out in Canada's First Submission, the CIRR is not a determinative benchmark.⁶⁷ The Appellate Body made this clear in the above-noted quotation and when it stated that "[t]he Article 21.5 Panel correctly concluded from our Report in *Brazil – Aircraft* that 'the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases'".⁶⁸

82. In ascertaining whether CIRR is an "appropriate" benchmark in a particular transaction or transactions, the issue is whether CIRR "reflect[s] the rates available in the marketplace".⁶⁹ This determination turns on whether the CIRR rate is in fact equivalent to the rates available in the marketplace for "comparable" transactions.

83. In the original Article 21.5 proceeding, the Appellate Body stated that in "identifying an 'appropriate' 'market benchmark' below the CIRR, a WTO Member must show that the 'benchmark' on which it relies is based on evidence from relevant, comparable transactions in the marketplace" [emphasis added].⁷⁰

84. Clearly, the terms and conditions of export financing transactions affect their comparability and the chosen benchmark must be comparable to the transaction(s) in question. Thus, where the CIRR rate varies from the rates available in comparable transactions in the marketplace, it is not an appropriate benchmark for the purposes of determining whether a "material advantage in the field of export credit terms" has been secured.

85. Beyond the issue of the interest rate itself, the export credit terms that must be considered in ascertaining whether export credit transactions are "comparable" have been, in part, articulated by the Appellate Body in the previous proceedings in this dispute and by this Panel in the original

⁶³ See Canada's First Submission, paras. 73-97.

⁶⁴ Brazil's First Submission, para. 64.

⁶⁵ *Id.*

⁶⁶ Article 21.5 Appellate Body Report, para. 64.

⁶⁷ Canada's First Submission, paras. 84-97.

⁶⁸ Article 21.5 Appellate Body Report, para. 63.

⁶⁹ *Id.*, para. 64.

⁷⁰ *Id.*, para. 74.

proceeding. The Appellate Body stated that "the terms and conditions of export credit transactions in the marketplace vary considerably, depending on the circumstances of a particular export credit transaction, such as the product involved, the size or volume of the transaction, the type of export credit practice, the duration of the repayment term, the type of interest rate (fixed or floating) used, and when the transaction is concluded".⁷¹

86. Further, the Appellate Body has acknowledged that "the commercial interest rate with respect to a loan in any given currency varies according to the length of maturity as well as the creditworthiness of the borrower".⁷² This Panel stated that "in its ordinary meaning, the field of export credit terms would refer to items directly related to export credits such as interest rates, grace periods, transaction costs, maturities and the like".⁷³

87. CIRR is not an appropriate benchmark for assessing whether PROEX III payments "secure a material advantage in the field of export credit terms" with respect to transactions involving regional aircraft because the CIRR rate usually varies significantly from the rates available in comparable transactions in the marketplace.

88. As discussed in paragraphs 78-79 of Canada's First Submission, the financing spreads required from airlines purchasing regional aircraft (as shown in the MSDW Report in Exhibit CDA-17) far exceed the spread incorporated in the U.S. dollar CIRR (a 100 basis point spread over the appropriate U.S. Treasury average). The spreads shown in the MSDW Report are for Enhanced Equipment Trust Certificates (EETCs). EETCs are a secured form of financing that feature a number of tranches with a varying level of priority claim over the aircraft. Each tranche will carry a rating that reflects the seniority of the claim on the aircraft as well as other credit enhancements that are designed to reduce risk.⁷⁴ As a result of these risk-reducing attributes, EETCs are tranches are usually rated well above the airline's unsecured debt rating. This enables the airlines (particularly those with lower credit ratings) to achieve lower overall debt pricing on aircraft financing. The initial loan-to-value ratios for the higher-rated EETC tranches are usually well below 70 percent of the initial fair market value, further reducing the risk profile associated with EETCs when compared to PROEX III support.⁷⁵ In its First Submission, Canada refers to an American Airlines EETC tranche trading at 135 basis points above U.S. Treasury rates. As the highest-rated EETC tranche for one of the highest rated U.S. airlines, this EETC tranche is a conservative relative benchmark when compared against the spreads required for financing regional aircraft, yet it is still 35 basis points higher than a rate achieved by the CIRR alone. A lender will certainly provide a borrower a material advantage if, by offering financing at the CIRR, it is permitted to offer a less credit-worthy borrower the same low interest rate as a more credit-worthy borrower.

89. The terms associated with the CIRR also vary significantly from the terms available in comparable transactions for regional aircraft. For example, the maximum term for the CIRR is ten years while the prevailing terms for financing regional aircraft are in the 15 year range.⁷⁶ Given the relationship between term and risk (the longer the term the higher the required spread),⁷⁷ a ten year CIRR rate cannot be a market benchmark for 15 year loans, nor is it comparable to financing prevailing in the regional aircraft market.

⁷¹ *Id.*, para. 73.

⁷² Original Appellate Body Report, para. 182.

⁷³ *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999, para. 7.28.

⁷⁴ See discussion in Standard & Poor's Structured Finance, *Aircraft Securitization Criteria*, (New York: Standard & Poor's, 1999), pp. 3-22. (Exhibit CDA-34)

⁷⁵ MSDW Report, (Exhibit CDA-17), p. 13. At page 15 of the Standard & Poor's Report, it is stated that for every 5 percent reduction in loan-to-value, credit ratings increase one notch.

⁷⁶ See also the CIT Presentation, *supra* note 76, p. 21, which evidences terms of up to 18 years.

⁷⁷ F.J. Fabozzi and T.D. Fabozzi, eds, *The Handbook of Fixed Income Securities*, 4th ed. (Burr Ridge, Illinois: Irwin, 1995), pp. 780 and 803-804. (Exhibit CDA-37)

90. Thus, it is clear that the CIRR is not an appropriate benchmark for transactions involving regional aircraft, as it very rarely reflects accurately the rates available in the marketplace. In this light, simply revising PROEX to set a floor based on the CIRR does not enable Brazil to establish a *prima facie* case that PROEX III payments do not secure a material advantage in the field of export credit terms.⁷⁸

VI. CONCLUSION

91. Canada requests that the Panel find that PROEX III financing support, whether on its own or administered in conjunction with BNDES financing, is a prohibited export subsidy under Article 3 of the SCM Agreement. Canada further requests that the Panel find that PROEX support does not qualify for the "safe haven" in the second paragraph of Item (k) in Annex I to the SCM Agreement; that there is no *a contrario* exception under the first paragraph of Item (k); and that even if there were, PROEX support would not qualify for it. Canada requests that the Panel find accordingly that Brazil has failed to implement measures that would bring it into compliance with the recommendations and rulings of the DSB.

⁷⁸ However, as noted earlier in this submission, Canada agrees that if Brazil brings its export subsidy practices into conformity with the relevant provisions of the OECD Arrangement, leaving aside the matter of Brazil's ongoing non-compliance by continuing to grant prohibited subsidies under PROEX I and II, this long-standing dispute would be resolved.

TABLE OF EXHIBITS

- CDA-19. Declaration of Ian Darnley, dated 21 March 2001.*
- CDA-20. "Acordo com Canadá está muito difícil" ("Tough Agreement with Canada") *Correio Braziliense* (31 August 2000) (Portuguese and English versions).
- CDA-21. D.C. Marin, "Governo altera os juros do Proex" ("Government changes Proex interest rates") *Valor Econômico* (7 December 2000) (Portuguese and English versions).
- CDA-22. A. Moreira and F. Paraguassu, "Canadá pede condenação do novo Proex na OMC" ("Canada requests condemnation of the new Proex in the WTO") *Gazeta Mercantil* (20 January 2001) (Portuguese and English versions).
- CDA-23. Statement by Brazil: DSB Meeting of 01 February 2001: Agenda Item 7.
- CDA-24. Letter from W.P. Jordan, Executive Vice President, Administration and General Counsel, United Express, operated by Air Wisconsin Airlines Corporation, to A. Sulzenko, Assistant Deputy Minister, Industry and Science Policy, dated 20 March 2001.
- CDA-25. Letter from Fairchild Dornier, dated 22 March 2001.*
- CDA-26. "SA Airlink Selects the ERJ 135 and Purchases 70 Units," Embraer Press Release, 14 December 2000, available on the Embraer website at <http://www.embraer.com/english/imprensa/index.htm>.
- CDA-27. Declaration of Hormuzd Irani, dated 21 March 2001.*
- CDA-28. Declaration of George Stevens, dated 20 March 2001.*
- CDA-29. *The New Shorter Oxford English Dictionary on Historical Principles*, v. 2 (Oxford: Clarendon Press, 1993), p. 3128 ("successor").
- CDA-30. *Black's Law Dictionary*, 7th ed. (St. Paul, Minn.: West, 1999), p. 1446 ("successor").
- CDA-31. *The Export Credit Arrangement: Achievements and Challenges 1978-1998* (Paris: OECD, 1998), pp. 9-11 and 17-21.
- CDA-32. "Illustrative List of Export Subsidies," Annex I to the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade ("the Subsidies Code") in *The Texts of the Tokyo Round Agreements* (Geneva: GATT, August 1996).
- CDA-33. *The Export Credit Arrangement: Achievements and Challenges 1978-1998* (Paris: OECD, 1998), pp. 24-25.

* Exhibits CDA-19, CDA-25, CDA-27, and CDA-28 are designated as "CONFIDENTIAL" pursuant to the Understanding on Rules and Procedures Governing the Settlement of Disputes, Appendix 3 - Working Procedures, para. 3; and *Brazil – Export Financing Programme for Aircraft: Second Recourse by Canada to Article 21.5 of the DSU* (WT/DS46), Working Procedures for the Panel, para. 3.

- CDA-34. Standard & Poor's Structured Finance, *Aircraft Securitization Criteria*, (New York: Standard & Poor's, 1999), pp. 3-22, available at www.standardandpoors.com/ResourceCenter/RatingsCriteria/StructuredFinance/articles/pdf/critairw.pdf.
- CDA-35. "CIT Structured Finance," Presentation to Aircraft Finance and Commercial Aviation Forum (February 2001).
- CDA-36. Spread of Industrial Index over US CIRR Rate for Repayment Terms in Excess of 8.5 Years.
- CDA-37. F.J. Fabozzi and T.D. Fabozzi, eds, *The Handbook of Fixed Income Securities*, 4th ed. (Burr Ridge, Illinois: Irwin, 1995), pages 780, 793-796, and 803-804.

ANNEX A-3

ORAL STATEMENT OF CANADA

(4 April 2001)

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I. INTRODUCTION

1. This is the third time since 1998 that this Panel has been called upon to decide whether the financial support that Brazil provides to foreign purchasers of its Embraer aircraft is an illegal export subsidy. In the original panel proceeding, Brazil maintained that its PROEX program was fully consistent with its WTO obligations. This Panel and the Appellate Body found otherwise. In November 1999, Brazil made some modest changes to its PROEX program, changes that it insisted brought it into compliance with its WTO obligations. Again, this Panel and the Appellate Body found otherwise.

2. On 6 December 2000, Brazil made another modification to its PROEX program. Under the Central Bank of Brazil Resolution 2799, Brazil allegedly limited its PROEX interest rate buy-downs

to the CIRR. Brazil has done nothing else to change the terms of its PROEX program since it was last found to be a prohibited export subsidy.

3. Brazil nevertheless claims that the revised PROEX scheme, PROEX III, is no longer a prohibited export subsidy. Alternatively, Brazil claims that even were it a prohibited export subsidy, PROEX III should be exempted from the disciplines of the SCM Agreement. According to Brazil, PROEX III qualifies for the so-called "safe haven" in the second paragraph of Item (k) of Annex 1 to the SCM Agreement. And if not there, Brazil asks this Panel to grant PROEX III a clean bill of health under an alleged *a contrario* exception in the first paragraph of Item (k).

4. In Canada's view, the single change that Brazil has made to its PROEX scheme fails to bring it into conformity with its WTO obligations. The only consistency in the arguments that Brazil has raised in its defence is Brazil's indefensible strategy of "buying time" while it continues to buy market share for Embraer.

5. In response, Canada has done two things. First, it has commenced this Article 21.5 proceeding to address Brazil's claim of conformity. Second, to limit the opportunity for Brazil to buy further market share while this proceeding runs its course, Canada has countered financing terms offered by Brazil to the Air Wisconsin Airlines Corporation by committing to provide equivalent financing, which would be offered through its Export Development Corporation.

6. In a separate proceeding, Brazil has called Canada's responsive commitment to do what Brazil is doing an illegal subsidy. We would be pardoned for considering that this indicates the real value of Brazil's claim of legality for PROEX III.

7. More fundamentally, Brazil's arguments fly in the face of the previous findings of law by this Panel, other panels and the Appellate Body and the overwhelming factual record. Brazil's arguments cannot be supported.

II. BENEFIT

8. First, Brazil contends that Canada has failed to establish that its PROEX III payments are prohibited subsidies. It asserts that its PROEX III payments are not subsidies at all because they do not confer a benefit.

A. CANADA HAS SATISFIED ITS BURDEN OF SHOWING PROEX III PAYMENTS ARE PROHIBITED SUBSIDIES

9. Brazil argues that Canada has the burden of proving that payments under PROEX III continue to be prohibited export subsidies. Brazil cites the Report of the Appellate Body in *Chile – Alcoholic Beverages* for the proposition that "PROEX III enjoys a presumption of compliance". It argues that the factual findings of the Panel and the Appellate Body on PROEX I and II are not relevant to a compliance assessment of PROEX III and that Canada has not otherwise presented sufficient evidence to discharge its burden¹

10. At paragraph 20 of its First Submission, Canada has acknowledged that it bears the burden to establish that PROEX III continues to be a prohibited export subsidy. To meet this burden, Canada must present a *prima facie* case: (a) that PROEX III financing support is a financial contribution; (b) that it confers a benefit; and (c) that the subsidy is contingent upon export performance.

11. However, contrary to Brazil's claim, the statement of the Appellate Body in *Chile – Alcoholic Beverages* does not provide authority for a "presumption of compliance". Rather, the Appellate Body

¹ Second Submission of Brazil, 23 March 2001, paras. 9-10.

found, in essence, that there should not be a presumption that a new measure is *non-compliant* simply because the measure it replaces was non-compliant. *Chile – Alcoholic Beverages* in no way modifies the burden of proof that applies to Canada in this case.

12. Brazil also contends that the factual findings by the Panel and the Appellate Body with respect to PROEX I and II are "irrelevant" to a compliance assessment of PROEX III. Brazil offers no basis for this assertion. The Appellate Body has made it clear that evidence relating to predecessor programs could be relevant to an Article 21.5 proceeding where the relevance of the evidence has been demonstrated by the complaining party²

13. The findings of the original Panel and Article 21.5 Panel referred to in footnotes 7, 9, 10, 21 and 22 and paragraph 23 of Canada's First Submission pertain to attributes of PROEX that have not been revised in PROEX III. PROEX payments still are grants to buy down commercial interest rates freely negotiated by the borrower. PROEX is still administered by the Committee, which retains the authority to waive all guidelines. PROEX payments to reduce the interest paid by a purchaser still are being provided in the form of NTN-I bonds.

14. Moreover, Brazil does not dispute that, just like its predecessors, PROEX III allows an aircraft purchaser to seek the best export credit terms available in the market, whether from a Brazilian or foreign financial institution, and then to receive a buy-down of that interest rate in the amount of the PROEX III payments.

15. Brazil contends that certain legal instruments, namely Central Bank of Brazil Circular 2881 and Directive 374, constrain the use of PROEX III. However, these instruments likewise applied to PROEX II. In the original Article 21.5 proceeding this Panel found that these instruments in no way constrained the terms on which Brazil could offer PROEX support. For Brazil to now simply assert again that these instruments constrain the terms on which Brazil can offer PROEX does not make it so.

16. The Panel's findings clearly remain relevant to whether PROEX III is consistent with the SCM Agreement. Moreover, they are corroborated by the other evidence that Canada has presented to the Panel.

17. In the legal arguments and evidence presented in paragraphs 23-25 of its First Submission and paragraphs 8-17 of its Rebuttal Submission, Canada has met the burden of proof that PROEX III subsidies are prohibited export subsidies. On its face and in practice, PROEX III support amounts to a financial contribution that confers a benefit. It therefore is a subsidy. It is *de jure* contingent upon export performance, something Brazil has not contested. Therefore, it is a prohibited export subsidy. Canada's argument applies equally whether PROEX III is provided alone or in conjunction with BNDES direct financing.

B. EVEN AT A CIRR FLOOR, PROEX III CONFERS A BENEFIT

18. At paragraph 13 of its Second Submission, Brazil argues that because PROEX III ostensibly establishes an interest rate floor based on the CIRR, this means that it confers no "benefit". Brazil also argues that prior statements by Canada regarding the relationship between the CIRR and commercial rates contradict Canada's position before this Panel that PROEX III continues to confer a benefit.

19. An examination of Canada's prior statements exposes Brazil's misrepresentation of Canada's position. Contrary to Brazil's contention, Canada never stated that it would not have brought this case

² Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU, Report of the Appellate Body (WT/DS70/AB/RW), para. 50.

if PROEX simply matched OECD rates and did not comply with the other relevant terms of the OECD Arrangement. In the passage to which Brazil refers, Canada was discussing the material advantage conferred by BNDES financing at interest rates above a LIBOR rate or the CIRR when combined with PROEX buy-downs of that rate to a still lower level. Canada indicated that it would not have brought this case if the combined effect of PROEX and BNDES was simply to achieve a rate above LIBOR or the CIRR³. This does not mean that Canada considers that buy-downs to the CIRR alone do not confer a benefit.

20. Canada has recognized, at paragraphs 16 and 17 of its Rebuttal Submission, that in certain circumstances the CIRR may be representative of, or even above, market rates. However, this does not establish that PROEX III does not confer a benefit. As Canada demonstrated in its First Submission, the CIRR alone, divorced from the other terms of the OECD Arrangement, does not reflect market realities⁴. Moreover, as Canada demonstrated in its Rebuttal Submission, the CIRR is substantially *below* market rates available to regional airlines for the purchase or lease of regional aircraft⁵.

21. Finally, Brazil has offered nothing to refute the most obvious evidence that PROEX III confers a benefit: PROEX III is offered to purchaser/borrowers to buy down interest rates that they have already negotiated in the commercial marketplace. The resulting bought down interest rates, even at the CIRR, therefore must be below-market rates. This Panel has already recognized this. At footnote 47 to its Report in the original Article 21.5 proceeding, it stated: "...PROEX payments by definition allow a purchaser/borrower to obtain export credits at interest rates lower than it could obtain in the market with respect to the transaction in question".

22. There can be no doubt that, even at the CIRR, PROEX III confers a benefit. If it did not, it would serve no purpose.

III. BRAZIL'S REVISED POSITION ON PARAGRAPH 2 OF ITEM (K) OF THE ILLUSTRATIVE LIST

23. Brazil contends that even if PROEX III is a prohibited export subsidy, it nevertheless qualifies for the "safe haven" in the second paragraph of Item (k).

24. Since Brazil's claim amounts to an affirmative defence, it bears the burden of proof and must demonstrate that its measures meet all of the conditions of the second paragraph of Item (k) to claim the exception⁶. Those conditions are, at a minimum, those specified by the *Canada-Aircraft* Article 21.5 Panel Report⁷.

25. Brazil notes in its Second Submission that Canada did not address the second paragraph of Item (k) in its First Submission. There is good reason for this. In this entire dispute, Brazil had never raised it as a defence. Now, by changing PROEX to ostensibly use the CIRR rate, and by changing nothing else, Brazil claims that PROEX III all of a sudden is "in conformity with" the "interest rates provisions". This is simply not the case.

³ *Brazil – Export Financing Programme for Aircraft*, Canada's Second Oral Submission to the Panel, para. 109.

⁴ Canada's First Written Submission, 2 March 2001, paras. 77-83 and 94-95.

⁵ Rebuttal Submission of Canada, 23 March 2001, paras. 87-90.

⁶ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, (WT/DS46/AB/RW), para. 66.

⁷ *Canada – Measures Affecting the Export of Civilian Aircraft, Recourse by Brazil to Article 21.5 of the DSU*, Report of the Panel, (WT/DS70/RW), at para. 5.147.

26. Specifically Brazil is asking this Panel to consider PROEX III to be "in conformity with" the "interest rates provisions" of the OECD Arrangement. When you consider Brazil's claim, recall the following:

- Brazil's claim flies in the face of its numerous public statements that it would not conform its measures to the OECD Arrangement;
- Brazil's claim ignores the fact that Brazil routinely waives any disciplines that its measures supposedly impose;
- Brazil's claim is at odds with the evidence from two recent cases that indicate that non-conforming terms were recently offered by Brazil through Embraer; and
- Brazil's claim ignores – and provides no evidence of "conformity" with – the vast majority of "interest rates provisions" as defined by the *Canada-Aircraft*, Article 21.5 Panel Report.

A. BRAZIL'S POSITION IS CONSISTENT WITH ITS DELAYING STRATEGY

27. Senior Brazilian officials have repeatedly stated that Brazil will not abide by the provisions of the OECD Arrangement in public statements, in statements to the DSU and in every one of the six negotiation and consultation sessions held between Canada and Brazil since the release of the original *Brazil – Aircraft* Article 21.5 Panel Report. Those statements are in Canada's written submissions. We do not need to repeat them.

28. Brazil's new position – claiming conformity with the second paragraph of Item (k) – would require a complete reversal of policy. This alleged reversal makes sense in the context of a delaying strategy. From the beginning, Brazil's strategy has been to delay implementation as long as possible while buying market share at whatever cost.

29. One article in a Brazilian newspaper described the strategy as follows: "[b]ut the major victory of the MFA refers to the fact that it was able to extend the dispute with Canada for almost four years. Meanwhile, Embraer became one of the biggest aircraft manufacturer[s] in the world. Today, the company has half of the world market for small aircraft (with up to 70 seats). In order to extend negotiations as much as possible, the MFA contracted big advocacy companies abroad specialized in international trade."⁸

30. As Canada stated in its Rebuttal Submission, if Brazil had indicated its intention to be "in conformity with" the "interest rates provisions" during the months of negotiations, and then followed that up with legitimate disciplines, this dispute would largely be resolved⁹. Instead, Brazil has refused to bring PROEX III into conformity and used the negotiations as a delaying tactic.

31. Two weeks ago, Canada put Brazil's claim of conformity with the OECD provisions to the test. On 22 March, Canada sent a letter by fax to Brazil's chief negotiator in this dispute. The letter states that: "[a] written commitment by Brazil that it has limited its export financing for regional aircraft to conform to the interest rate provisions of the OECD Arrangement would go a long way towards resolving this dispute. If Brazil is prepared to provide this commitment, Canada would

⁸ Guilherme Barros, "Canada can retaliate against Brazil by US\$1.3 billion" *Folha de Sao Paulo* (22 August 2000) (Exhibit CDA-38).

⁹ At para. 19.

propose the suspension of all current dispute settlement proceedings ... and the resumption of negotiations....¹⁰ Canada has not received a response.

B. BRAZIL HAS ALREADY BEEN FOUND TO WAIVE ITS PROEX "REQUIREMENTS"

32. Not only do Brazil's public statements point to non-conformity with the OECD Arrangement, but, as Canada noted at paragraph 28 of its Rebuttal Submission, Brazil has admitted to waiving so-called requirements that on their face might appear to limit the terms of the financing it can offer.

33. Brazil claims that Circular 2881 and Directive 374 limit the maximum length of the financing term to 10 years and the maximum percentage for interest rate equalization to 85% of the export value of the sale.

34. In the case of Circular 2881, Brazil is repeating an argument that was rejected by this very Panel in the previous Article 21.5 proceeding¹¹ Directive 374 applied to PROEX II and has not, to Canada's knowledge, been revised for PROEX III. These documents did not impose any disciplines on PROEX II. Nor do they impose any disciplines on PROEX III.

C. PROEX III FINANCING SUPPORT OFFERED BY BRAZIL DEPARTS FROM THE OECD ARRANGEMENT

35. Brazil's actual practice confirms its non-conformity with the "interest rates provisions" of the OECD Arrangement. In two recent cases, detailed in Canada's Rebuttal Submission, Brazil offered financing support through Embraer that was not "in conformity with" the "interest rates provisions" of the OECD Arrangement.

36. Brazil itself seems to believe that its measures do not conform to the interest rates provisions of the OECD Arrangement - for it offers no evidence of conformity. Although Brazil contends that its measures conform to either the 1998 or 1992 version of the Arrangement, it fails to even mention most of the 1998 articles. And with respect to the 1992 version, Canada has demonstrated that Brazil's measures do not even meet Brazil's own limited definition of interest rates provisions - specifically the 10 year term limitation.

D. THE 1998 VERSION OF THE OECD ARRANGEMENT IS RELEVANT FOR THE PURPOSES OF THE SECOND PARAGRAPH OF ITEM (K)

37. Brazil also claims that it is the 1992 version of the OECD Arrangement that is relevant to this Panel's enquiry. This is clearly at odds with the ordinary meaning of the second paragraph of Item (k). Brazil argues that the phrase referring to an international undertaking which "has been" adopted, refers to a "'time regarded as present' when the text became effective on 1 January 1995." This is not so. The ordinary meaning of the phrase requires a determination of whether a successor arrangement "has", in the present, "been adopted". With respect to PROEX III, this means that the 1998 OECD Arrangement applies. The U.S. and the European Communities support Canada in this interpretation¹²

38. Brazil further claims that interpreting Item (k) second paragraph to include post-1995 successor undertakings of the Arrangement would effectively result in an amendment, by a sub-group

¹⁰ Letter from C. Carriere, Director General, General Trade Policy Bureau, Canada's Department of Foreign Affairs and International Trade, to Ambassador J.A. Graca Lima, Undersecretary General for Integration, Economic Affairs and Foreign Trade, Brazil's Ministry of Foreign Affairs, dated 21 March 2001 (Exhibit CDA-39).

¹¹ At para. 2.4.

¹² See Third Party Submission of the United States, 23 March 2001, paras. 4 - 10; and Third Party Submission by the European Communities, 23 March 2001, paras. 15 - 23.

of Members, of the SCM Agreement. Again, Brazil's interpretation is erroneous. The text "successor undertaking" specifically contemplates that the Arrangement would evolve over time. The *Canada – Aircraft* Article 21.5 Panel shared this view. Moreover, this evolution is fair: it is exactly what Members accepted when they agreed to the WTO Agreements. Again, the U.S. and the European Communities support Canada in this conclusion¹³

39. Finally, it should be noted that since the WTO Agreement post-dates the 1992 Arrangement by three years, the drafters could have simply referred to the 1992 Arrangement if they had intended that it apply regardless of future changes. The use of the language in the second paragraph of Item (k) indicates the opposite – that the drafters knew that future changes to the Arrangement would occur and that they intended for those changes to apply when a Member claimed the second paragraph "safe haven".

IV. PROEX III DOES NOT QUALIFY FOR AN ALLEGED A *CONTRARIO* EXCEPTION UNDER ITEM (K), FIRST PARAGRAPH

40. Canada has already explained at length in its previous submissions why the first paragraph of Item (k) cannot be read as creating an *a contrario* exception and why, even if it could, PROEX III would not qualify. Still, a few contentions in Brazil's Second Submission call for a response.

A. THE FIRST PARAGRAPH OF ITEM (K) DOES NOT SUPPORT AN A *CONTRARIO* EXCEPTION

41. At paragraph 19 of its Second Submission, Brazil contends that the Panel must give meaning and effect to the material advantage clause in the first paragraph of Item (k). It then contends that the "ordinary, straightforward meaning" of the material advantage clause is that payments that are used to secure a material advantage are prohibited subsidies, whereas payments that are not so used are not prohibited. It argues that logically, the drafters of Item (k) intended that payments that did not secure a material advantage would not be proscribed.

42. The more straightforward reading of Item (k) is that payments that do not secure a material advantage are not *per se* prohibited export subsidies on the Illustrative List but may nevertheless be prohibited export subsidies. The language in the first paragraph of Item (k) distinguishes between payments that are used to secure a material advantage and those that are not. However, it does not follow that the ordinary meaning of the material advantage clause is the *a contrario* meaning that Brazil proposes. Nor is Brazil's interpretation required to give meaning and effect to the clause.

43. Instead, the ordinary meaning of the distinction created by the clause is that measures that secure a material advantage are to be considered *per se* prohibited subsidies, (as they are included on the Illustrative List of such subsidies), without regard to the tests set out in Articles 1 or 3.1 of the SCM Agreement. By contrast, if a measure does not secure a material advantage, it is not one of the *per se* prohibited subsidies on the Illustrative List, but that does not mean that it is not a prohibited subsidy. It is still a prohibited subsidy if the complaining Member establishes that it is a subsidy under Article 1 and contingent upon export performance under Article 3.1. This is a far more "straightforward" interpretation of the terms of the SCM Agreement, in their context, than that advocated by Brazil.

44. Nor, contrary to Brazil's assertion at paragraph 23 of its Second Submission, has Canada suggested that the material advantage clause is the result of inadvertence. The English case to which Lord McNair referred in *The Law of Treaties* stands for the principle that the *a contrario* maxim should be applied carefully, with due regard to context, and is not automatic in its application, a point

¹³ See Third Party Submission of the United States, 23 March 2001, paras. 8 – 10; and Third Party Submission by the European Communities, 23 March 2001, paras. 24 – 33.

with which Brazil seems to agree¹⁴ In the present case, there are compelling reasons why Item (k) should not be interpreted *a contrario*. These reasons have nothing to do with inadvertence and everything to do with the context of Item (k) in the SCM Agreement.

45. Before turning to this context, Canada first notes that in the same paragraph of its Second Submission in which Brazil confuses Canada's reference to Lord McNair's text, Brazil also cites paragraph 20 of the original Report of the Appellate Body in this dispute for the proposition that the "material advantage" clause was deliberately added to "restrict the definition of this type of export subsidy to instances where a 'material advantage' has been secured."

46. However, paragraph 20 of the original Appellate Body Report does not support the proposition for which Brazil has cited it. Paragraph 20 is in the section of the Report entitled "Arguments of the Participants and the Third Participants, Claims of Error by Brazil – Appellant". It is not a finding by the Appellate Body but rather, a description of Brazil's arguments.

47. In fact, the Appellate Body never made findings regarding the history of the first paragraph of Item (k) and the object and purpose of the "material advantage" clause. Moreover, there is no evidence to establish, or even suggest, that the material advantage clause was added to "restrict the definition of this type of export subsidy to instances where a 'material advantage' has been secured".

48. The material advantage clause restricts the types of export subsidies that are "illustrated" in the Illustrative List. It does not – and cannot – circumscribe the conditions under which a subsidy is contingent upon export performance through the application of Articles 1 and 3.

49. In the eight or so paragraphs that follow paragraph 23 in its Second Submission, Brazil seeks to find support for its *a contrario* position in the negotiating history of Item (k). Brazil refers to the negotiating history to demonstrate that the material advantage clause was not added inadvertently, a claim that Canada has not made. Brazil's approach to the "material advantage" clause is wrong and its arguments regarding the negotiating history are misplaced because they ignore Articles 1 and 3 and footnote 5, three provisions of the SCM Agreement that were not part of the Tokyo Round Code. These provisions provide the critical context for the interpretation of Item (k) first paragraph.

50. As Canada noted in paragraph 47 of its First Submission, footnote 5 recognizes that Annex I contains certain exceptions to the general prohibition in Article 3. Footnote 5 is an explicit exclusionary clause. Brazil would interpret the Illustrative List to implicitly allow certain export subsidies *a contrario* simply because it identifies other types of measures as prohibited export subsidies. However, as this Panel recognized in its Report in the Article 21.5 proceeding, this would make footnote 5 redundant¹⁵

51. Brazil challenges Canada's characterization of footnote 5 as an explicit exclusionary clause because it does not contain the word "expressly". Brazil argues that Canada's position means that the word "expressly" should be read into footnote 5. It also argues that the Panel, in the original Article 21.5 proceeding, noted that the word "expressly" was dropped from an earlier draft of the language of footnote 5, which apparently broadened its meaning¹⁶

52. According to Brazil, because footnote 5 does not contain the word "expressly", as in "Measures *expressly* referred to in Annex I as not constituting exports subsidies shall not be prohibited...", footnote 5 is not meaningful context for the interpretation of Item (k) in Annex I. Brazil's arguments parallel an argument advanced by the United States and rejected by the Panel in

¹⁴ Brazil 's Second Submission, para. 23.

¹⁵ At para. 6.41.

¹⁶ Second Submission of Brazil, para. 33.

the original Article 21.5 proceeding¹⁷ Brazil's arguments misconstrue both Canada's position and the finding of the Panel in its Article 21.5 Report.

53. In Canada's view, it was necessary for the drafters to remove the word "expressly" from footnote 5 because Annex I includes only one express reference to measures "not constituting export subsidies". That reference is in the second paragraph of Item (k), which provides that an export credit practice which is in conformity with the interest rate provisions of a relevant undertaking "shall not be considered an export subsidy prohibited by this Agreement".

54. However, Annex I also includes affirmative statements that authorize the use of certain measures without explicitly stating that the measures do not constitute export subsidies. These statements are found in Item (h) and Item (i) and in footnote 59 to Item (e) of the Illustrative List. Had the drafters used the word "expressly" in footnote 5, it would have nullified the legal effect of these latter statements.

55. Canada's position is that in footnote 5, the "measures referred to in Annex I as not constituting export subsidies" are measures for which there is positive authorization in Annex I that a measure is not being categorized as a prohibited subsidy. Canada's position is consistent with the relevant finding of the Panel in the Article 21.5 proceeding:

... the Illustrative List contains – and already contained at the time of *Cartland III* and *IV* – a number of provisions that include affirmative statements that arguably represent authorizations to use certain measures. The language of *Cartland III* ("expressly referred to") could have precluded asserting that footnote 5 applied to any of these provisions, and it may be that the purpose of the modification was to rectify this situation. If on the other hand the intention of the drafters in changing footnote 5 had been to extend the scope of that footnote to cover situations where the Illustrative List merely referred to things that *were* export subsidies, they might have been expected to modify the structure of the second part of the footnote, and not merely delete the word "expressly"¹⁸

56. The Panel's findings support Canada's position. By removing the word "expressly" from the text of footnote 5 the drafters avoided a reading of the Illustrative List that would have prevented Members from taking measures that were affirmatively authorized but were not expressly deemed not to be prohibited export subsidies. Far from making footnote 5 too vague to be useful in interpreting Annex I, by removing "expressly" the drafters clarified that under footnote 5 the measures affirmatively referred to in Annex I are not prohibited subsidies. Having done so, there is no reason why the drafters would have intended, as Brazil would have it, that subsidies also should not be prohibited when they are *not referred to* in Item (k).

57. At paragraph 36 of its Second Submission, Brazil argues that Canada's interpretation of footnote 5 is undermined by item (i) of the Illustrative List, because Item (i) must also be interpreted *a contrario*. Brazil's explanation of Item (i) omits important aspects of the provision and it ignores the relationship between the items in the Illustrative List and other relevant provisions in the SCM Agreement and the GATT 1994. Item (i) demonstrates why Canada's approach to interpreting the Illustrative List within its context is the correct approach.

58. Brazil's *a contrario* approach focuses exclusively on the introductory language of Item (i). It ignores the relevant contextual elements of the provision. By its own terms, Item (i) must be interpreted in accordance with the guidelines in Annexes II and III of the SCM Agreement. By virtue of footnote 1 to the SCM Agreement, "in accordance with the provisions of Article XVI of GATT

¹⁷ At para. 6.40.

¹⁸ Para. 6.40.

1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the... remission of duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy".

59. Thus, the non-excessive remission of import charges, to the extent that such charges are "duties" within the meaning of footnote 1, is not a subsidy. Contrary to Brazil's assertion, the negotiators could not have drafted Item (i) with a period or full stop after the word "charges" because it would have created an inconsistency with footnote 1 of the SCM Agreement.

60. Accordingly, it is not by reading Item (i) *a contrario* that one can determine that non-excessive remission does not amount to a prohibited export subsidy, but by referring to the other provisions of the SCM Agreement that clearly establish that such remissions do not amount to a subsidy. Standing alone, Item (i) would provide merely that non-excessive remission is not *per se* prohibited, i.e., that non-excessive remission is not illustrated on the Illustrative List. The same is true of Item (k).

B. PROEX III PAYMENTS ARE NOT "PAYMENTS" WITHIN THE MEANING OF THE FIRST PARAGRAPH OF ITEM (K)

61. The first paragraph of Item (k) refers to the payment of the costs incurred by exporters or financial institutions in obtaining export credits. In the original Article 21.5 proceeding, this Panel found, correctly in Canada's view, that PROEX payments do not cover the cost incurred by financial institutions or exporters in obtaining export credits. It found that interest-rate buy-downs for purchasers of Embraer aircraft are not payments of a lender's cost of obtaining export credits. It found further that even if the provision of export credits at below the cost of borrowing was a cost incurred in obtaining credits, PROEX payments, being paid to foreign banks, did not necessarily serve to reimburse these costs¹⁹

62. Brazil argues that PROEX payments do fit the definition of payments in the first paragraph of Item (k) and suggests that if they do not, Canada has failed to explain the kind of payments that are contemplated in that paragraph.

63. Canada has consistently argued that "payments" in the first paragraph of Item (k) refers to situations where an exporter or a financial institution incurs costs by obtaining credits at rates higher than those at which it lends to a purchaser, and a government pays for all or part of this difference²⁰ PROEX payments are not payments to cover the costs incurred by exporters or Brazilian financial institutions in raising funds used for financing purchases. They are simply cash grants made for the benefit of purchasers of Brazilian exported regional aircraft. Therefore they do not fit within the first paragraph of Item (k).

64. PROEX payments are available to purchasers even when, as in many cases, they finance their purchases outside Brazil and through non-Brazilian financial institutions. In such instances, any "payments" by Brazil do not cover the cost incurred by a financial institution or an exporter in "obtaining credits". Moreover, even if financing is offered by Brazilian financial institutions, PROEX payments are made to reduce interest rates below market rates, rather than to reimburse an exporter or a financial institution for costs incurred in obtaining credits. There is no evidence that PROEX payments reimburse an exporter or a financial institution for anything.

65. Canada notes that the United States, in its third party submission, has taken the position that PROEX interest rate buy-downs constitute "payments" within the meaning of the first paragraph of

¹⁹ At paras. 6.71-6.73.

²⁰ See e.g. Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU, Report of the Panel, at para. 6.70.

Item (k). The United States acknowledges that there is very little guidance on the interpretation of the "payment clause". However, it contends that the intent of the clause is to reduce the risk to the exporter or the financial institution lending money to a borrower. The United States also acknowledges that interest rate buy-downs do not constitute a direct payment but argues that they reduce the risk incurred by the exporter or financial institution and therefore fall within what it considers to be the scope of the clause²¹

66. The interpretation of the payment clause suggested by the United States is inconsistent with the plain meaning of the terms in the first paragraph of Item (k). As noted by this Panel, the second part of the first paragraph of Item (k) refers only to payments made to cover the cost incurred in obtaining export credits. An interpreter is not free to read into the provision language to include any measure that might reduce the risks that exporters or the financial institutions incur in lending money. Interpreting the clause to cover costs not incurred in obtaining export credits would render meaningless the words "payment... of... costs... incurred in obtaining credits". It would mean that the first paragraph of Item (k) would extend to such other costs as loan guarantees. This would considerably expand the category of export subsidies that are *per se* prohibited under Item (k).

C. PROEX III SECURES A MATERIAL ADVANTAGE

67. Canada has explained in its First and Rebuttal Submissions, why PROEX III confers a material advantage. Canada has shown, with reference to the commercial marketplace, why PROEX III confers an advantage that is clearly material²². Simply put interest rates that PROEX III makes available even to higher-rated aircraft purchasers are significantly lower than the rates available to the highest-rated purchasers using low-risk secured debt instruments to finance their purchases. *A fortiori*, the same is true of PROEX III support for lower-rated aircraft purchasers.

68. Canada has also demonstrated why the CIRR alone, stripped of the other disciplines of the OECD Arrangement and independent of the characteristics of applicable commercial transactions including the creditworthiness of the borrower, is not representative of any market and cannot be considered an appropriate benchmark²³

69. Accordingly, even if the first paragraph of Item (k) did give rise to an *a contrario* exception – which it does not – and even if PROEX III payments were payments within the meaning of that paragraph – which they are not – PROEX III payments would still not qualify for the exception because they secure a material advantage in the field of export credit terms.

V. CONCLUSION

70. In this, the third proceeding to determine whether Brazil's PROEX scheme is consistent with its WTO obligations, Brazil has resorted to repeating arguments that have been previously rejected by this Panel and the Appellate Body, or to taking positions that are entirely at odds with the facts, or both.

71. Brazil's approach brings to mind an old story, in which Abraham Lincoln is asked, "If you call a horse' s tail a leg, how many legs does the horse have?". Mr. Lincoln's answer was, of course, "Four. Calling a tail a leg does not make it a leg. It is still a tail."

²¹ Third Party Submission of the United States, paras. 19-20.

²² E.g. First Written Submission of Canada, paras. 73-83.

²³ E.g. First Written Submission of Canada, paras. 84-97.

72. Brazil can claim that PROEX III does not confer a benefit. It can claim that it qualifies for the safe haven in the second paragraph of Item (k). And it can claim that it qualifies for an alleged *a contrario* exception in the first paragraph of Item (k). But claiming that it is so cannot make it so when the law and the facts show otherwise.

73. The latest version of Brazil's PROEX scheme is still a prohibited export subsidy. Canada requests that this Panel find accordingly.

ANNEX A-4

RESPONSES BY CANADA TO QUESTIONS OF THE PANEL

(17 April 2001)

For Canada

Q15. Please explain precisely what measures you are challenging in these proceedings. Is it the legal framework of PROEX III in so far as it relates to financing the export of regional aircraft, i.e. PROEX III as such? Or payments under PROEX III?

1. As noted in Canada's oral response to this question, Brazil claims in its First Submission that by amending PROEX through BCB 2799, it has brought PROEX into conformity with the SCM Agreement. Brazil claims that by virtue of this amendment, PROEX III payments are no longer prohibited export subsidies. Canada disagrees. Canada is challenging the PROEX III scheme in so far as it relates to the financing of exports of regional aircraft because, however it is delivered,¹ it enables Brazil to continue to grant prohibited export subsidies. It is also challenging PROEX III payments made in support of regional aircraft exports. Payments under PROEX III remain prohibited export subsidies. Accordingly, Brazil has failed to comply with the recommendations and rulings of the DSB.

2. The situation is akin to that described by the Panel in its Report in the original (PROEX I) proceeding:

... we understand Canada to be challenging not only specific payments, but more generally the practice involving PROEX payments relating to exported Brazilian regional aircraft ... In order to analyse this contention, we are required to go beyond an examination of individual PROEX payments that have been identified and look more generally at the nature and operation of the PROEX interest rate equalization scheme which governs the payment of the alleged export subsidies".²

Q16. Canada cites Article 13 of the 1998 OECD Arrangement regarding repayment schedules. Article 13(a) however uses the term "normally". Please comment.

1. Article 13(a) defines the minimum repayment schedule that is expected for transactions that comply with the disciplines of the Arrangement. The term "normally" refers to the possibility that one may wish to establish a different repayment schedule under special circumstances, as envisaged in paragraph (c) of the same article. In that event, paragraph (c) requires that the appropriate notification procedures be followed (detailed in Article 49(a)2) of the Arrangement).

2. However, it is important to note that this flexibility does not apply to the timing of the first instalment of principal, which must be made at or before 6 months from the starting point of credit (as defined in Article 9) regardless of the repayment schedule. The term "normally" only qualifies the reference to "equal and regular instalments not less frequently than every six months". It does not qualify the "first instalment" language. This interpretation is confirmed by the context of this provision within the Arrangement, namely by the "No Derogation Engagement" of Article 27(a).

¹ See Canada's Rebuttal Submission, para. 2.

² *Brazil – Export Financing Programme for Aircraft*, Report of the Panel, WT/DS46/R, adopted 20 August 1999, para. 7.2.

3. Thus, the unlimited grace period allowed under Article 2 of Brazil's Directive 374 enables the Export Credit Committee to approve transactions that would not respect Article 13(a) of the Arrangement by approving transaction in which the first payment of principal is made more than six months after the starting point of credit.

Q17. Do you agree that PROEX III payments are "interest rate support" within the meaning of the 1998 OECD Arrangement? If not, why not?

1. The 1998 OECD Arrangement does not define "interest rate support". However, interest rate support practices of the Participants to the Arrangement have the following characteristics:

- The level of support is determined in relation to the interest rate prevailing in the market at the time when support is established;
- The amount paid by the government varies according to the difference between the short-term interest rate that prevails in the market during the period over which the financing is provided and the level at which the interest rate was fixed for the borrower. Theoretically the payment is therefore a two-way flow because there may be times at which the market rate will be below the rate at which support was fixed, which would require the financial institution to pay back part of the support; and
- Credit risk insurance or a guarantee is provided in association with interest rate support to limit the risk of non-repayment from the borrower because this risk is not covered by pure interest rate support. Participants provide credit risk insurance or guarantees in conjunction with interest support to cover that risk. This is done through the addition of a risk premium to the interest rate and the Arrangement defines minimum premium benchmarks to ensure that credit risk is appropriately covered.

2. Whether or not PROEX III payments are "interest rate support" within the meaning of the 1998 OECD Arrangement, they do not conform with the interest rates provisions of the 1998 OECD arrangement and are significantly different from the interest rate support practices of the Participants:

- The level of buy-down provided by PROEX is divorced from the interest rate that prevails in the market when the transaction is approved. In fact, BCB Newsletter No. 2881³ indicates Brazil's intention to provide the maximum buy-down possible (2.5%) in cases where the term of the loan is over 9 years;
- PROEX III buy-downs constitute a one-way flow from the government to the lending institution, instead of the two-way flow associated with interest rate equalisation; and
- As previously mentioned, interest rate support does not cover the credit risk associated with a transaction. The lender therefore remains subject to the risk of non-payment by the borrower. Even if interest rate support is provided by a government, it is difficult to see why a lender would agree to extend a fixed rate loan without the possibility to cover itself for the credit risk it is taking, in particular if the transaction involves a fair amount of risk.

Q18. Canada contends that the "CIRR is not an appropriate benchmark ... with respect to transactions involving regional aircraft because the CIRR rate usually varies significantly from the rates available in comparable transactions in the marketplace" (Canada's rebuttal submission, para. 87). Is Canada asserting that the Appellate Body was not aware of the financing spreads required from airlines purchasing regional aircraft when it stated, in its

³ See Exhibit CDA-2.

Article 21.5 report in Brazil – Aircraft, that Brazil, to discharge its burden of establishing that under the revised PROEX subsidies were not used to secure a material advantage, had to prove "either: that the net interest rates under the revised PROEX are at or above the relevant CIRR ... or ..."? (para. 67) If so, what is the basis for this assertion?

1. No. In this proceeding, Canada has challenged Brazil's selection of the CIRR as an appropriate benchmark. In the previous proceedings in this dispute, the Appellate Body did not have to pronounce on the "appropriateness" of the CIRR as a generalized benchmark because Brazil failed to make a *prima facie* case that the interest rates under PROEX I or PROEX II were at or above the relevant CIRR or some other benchmark.

2. While Canada cannot speak for the Appellate Body, Canada believes that the Appellate Body made clear that it considered the CIRR relevant because the Appellate Body thought that the CIRR was a market benchmark, not because the CIRR had any independent legal status. In Canada's view, the Appellate Body did not intend the CIRR to be a conclusive generalized benchmark if it were not a market benchmark. In its Report in the original proceeding, the Appellate Body recognized that: "[t]he fact that a particular *net* interest rate is below the relevant CIRR is a positive indication that the government payment in that case has been 'used to secure a material advantage in the field of export credit terms'". [underlining added]⁴

3. However, the Appellate Body also stated that: "[i]n any given case, whether or not a government payment is used to secure a *material* advantage ... may well depend on where the net interest rate applicable to the particular transaction at issue in that case stands in relation to the range of commercial rates available."⁵

4. Moreover, in its Report in the first Article 21.5 proceeding in this dispute, the Appellate Body acknowledged that "the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases".⁶ This statement was in response to evidence that in some instances the market may be below the CIRR.

5. Canada has presented detailed argument and evidence before this Panel at paragraphs 84 to 97 of its First Submission and at paragraphs 78 to 90 of its Rebuttal Submission demonstrating that CIRR is not an appropriate benchmark in regional aircraft transactions because it does not appropriately reflect the rates at which regional aircraft financing is generally offered in the commercial marketplace.

6. The CIRR interest rate in most cases will be well below commercial rates available for regional aircraft transactions. For example, as demonstrated in paragraph 88 of Canada's Rebuttal Submission, the CIRR is 35 basis points lower than a rate achieved by the highest-rated EETC tranche for one of the highest rated U.S. airlines (American Airlines). Canada also demonstrated, at paragraphs 76-77 of its First Submission and in Exhibit CDA-16, that buy-downs in interest rates to the CIRR would confer a material advantage in favour of Brazilian regional aircraft exports.

7. Furthermore, such an advantage would exist even without taking into account the other "terms and conditions of export credit transactions in the marketplace", to use the Appellate Body's words.⁷ As Canada has shown, for example at paragraphs 80-83 of its First Submission, PROEX III buy-

⁴ *Brazil – Export Financing Programme for Aircraft*, Report of the Appellate Body, WT/DS46/AB/R, adopted 20 August 1999, para. 182.

⁵ *Ibid.*

⁶ *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Appellate Body, WT/DS46/AB/RW, para. 63.

⁷ *Ibid.*, para. 73.

downs to the CIRR, divorced from these other terms and conditions, are even less reflective of regional aircraft financing in the commercial marketplace.

8. In the light of this evidence, Brazil cannot, by allegedly limiting PROEX III buy-downs to the CIRR, establish a *prima facie* case that PROEX financing does not secure a material advantage.

Q19. How can Canada's assertion that a benchmark other than CIRR "must be used" in cases where "the CIRR rate is not an adequate proxy for market rates" (Canada's first written submission, para. 92; emphasis added) be reconciled with the Appellate Body's statement, in its Article 21.5 report in Brazil – Aircraft, that, where the CIRR does not reflect the rates available in the marketplace, a Member "should be able, in principle, to rely on evidence from the marketplace itself in order to establish an alternative 'market benchmark'" (para. 64; emphasis added)?

1. Canada's position is consistent with the Appellate Body's statement. In accordance with paragraph 64 of the Appellate Body's Report, a Member, in that case a defending Member, may rely on evidence from the marketplace to demonstrate to a panel, as the trier of fact, that the CIRR is not an appropriate generalized benchmark in the circumstances, and that an alternative benchmark is appropriate.

2. It cannot be that this right to demonstrate that the CIRR is not an appropriate benchmark accrues only to a party complained against. In this proceeding, Canada, as the complaining party, has demonstrated that the CIRR is not an appropriate generalized market benchmark because it does not generally reflect the rates available in the commercial marketplace for the financing of regional aircraft. The burden remains on Brazil, as the party asserting an affirmative defence, to establish an alternative generalized benchmark that is appropriate. It has not done so.

Q20. Can it be inferred from paras. 67 and 73 of the Appellate Body's Article 21.5 report in Brazil – Aircraft that the CIRR is a generalized market benchmark applicable to all export credit transactions relating to regional aircraft? If not, why not?

1. No. In paragraphs 67 and 73 of its Article 21.5 Report, the Appellate Body was considering the CIRR as a generalized *market* benchmark. The CIRR can be a generalized market benchmark applicable to all export credit transactions relating to regional aircraft only if, as a general matter, it accurately reflects market rates for such transactions. As discussed, *supra*, in Canada's response to Question 18 and in Canada's Rebuttal Submission at paragraph 80, the Appellate Body recognized this. It did not intend the CIRR to be used as a benchmark if it did not accurately reflect the market and it acknowledged that CIRR might not do so. Canada has demonstrated that the CIRR does not do so.

For both parties

Q21. On the assumption that the second paragraph of item (k) provides for an exception to the first paragraph thereof, would a Member invoking the second paragraph need to establish (i) that its internal law allows it to act in conformity with the interest rates provisions of the relevant OECD Arrangement or (ii) that its internal law requires it to act in conformity with the aforementioned interest rates provisions? If (ii) is correct, how does this view fit with the traditional distinction between mandatory and discretionary legislation in the GATT/WTO?

1. The traditional distinction in GATT and WTO jurisprudence between mandatory and discretionary legislation, at least until the Panel report in *United States – Section 301*, was that only legislation mandating a WTO inconsistency or precluding consistency could, as such, violate WTO

provisions.⁸ In the traditional view, it was not sufficient for a complaining Member to show that the impugned measure might allow the Member complained against to violate its WTO obligations but rather, that it the measure required, or would require, the Member to violate its obligations in at least some circumstances.

2. This distinction addressed the question of what a complaining Member had to show in challenging legislation, order to establish a violation of WTO obligations. The distinction did not address the question of what a Member complained against must show in order to establish an affirmative defence. It therefore is not applicable to the question of what a Member must do in order to invoke the second paragraph of Item (k) as an affirmative defence.

3. A Member invoking the second paragraph of Item (k) must establish that its challenged actions are in conformity with the interest rates provisions of the OECD Arrangement. A demonstration that the Member's internal law allows it to act in conformity with the interest rates provisions of the OECD Arrangement would be insufficient. The Member would not have met its burden of establishing its affirmative defence, because it would not have shown that its actions are in conformity with the interest rates provisions of the OECD Arrangement. Given the presumption that a Member will act in accordance with its domestic legal requirements, one way for a Member to meet its burden would be to show that its internal law requires it to act in conformity with the interest rates provisions of the OECD Arrangement.

4. In the present case, Brazil has not met its burden of establishing its affirmative defence. It has not shown that its internal law mandates that it act in conformity with the interest rates provisions of the relevant OECD Arrangement. Nor has it established, through other authoritative actions, that it is bound by the interest rates provisions of the OECD Arrangement.

5. Canada has established that PROEX III does not even address, let alone require conformity with, all of the interest rates provisions of Arrangement (regardless of which version of the Arrangement is the relevant one). Brazil has claimed that, in addition to the CIRR, it conforms to two of the interest rates provisions of the OECD Arrangement, namely the maximum length of the financing term and the loan-to-value limitation. However, as Canada showed at paragraphs 27 to 30 of its Rebuttal Submission, the documents on which Brazil relies for this contention were in effect under PROEX II, during which period Brazil routinely waived these terms for regional aircraft financing. Furthermore, as noted in Canada's response to Question 32, Directive 374 on its face allows Brazil to offer financing on payment terms that exceed the 10 year limit in the OECD Arrangement. In the course of the oral hearing in this proceeding, Brazil admitted that it retained the power to waive these two terms. Moreover, Brazil offered no assurances that it would not continue to do so, nor could it have credibly done so, given the array of public statements by Brazilian officials that Brazil will not comply with the interest rates provisions of the OECD Arrangement.⁹

6. In addition, at paragraphs 32-36 of its Rebuttal Submission, Canada submitted uncontroverted evidence that PROEX financing support has been offered on terms inconsistent with the interest rates provisions of the OECD Arrangement in the period since PROEX III took effect.

7. In the face of the evidence against it, Brazil has failed to show that PROEX III, however it is delivered, is in conformity with the interest rates provisions of the OECD Arrangement. It cannot meet its burden, regardless of any distinction between mandatory and discretionary legislation.

8. Even if the mandatory/discretionary distinction were relevant to an affirmative defence, Brazil would need to demonstrate that it is mandating to conform to the interest rates provisions of the

⁸ *United States – Sections 301-310 of the Trade Act of 1974*, WT/DS152/R, adopted 27 January 2000, fn. 675.

⁹ See Canada's Rebuttal Submission, paras. 20-26.

relevant OECD Arrangement. However, as described in the preceding paragraphs, Brazil has stated publicly that it will not comply with the interest rates provisions, and there is unrebutted evidence that it has not complied. Finally, there is a well-established history of Brazil's non-compliance under the same instruments that it is now asserting establish its compliance. In these circumstances, there is no basis for finding that Brazil has brought its measures into compliance with its obligations in this dispute.

Q22. The Panel in United States – Section 301 (WT/DS152/R, para. 7.96) found legislation presumptively inconsistent with the WTO Agreement in a case where legislation provided discretion to act in a WTO-inconsistent manner. Do the findings of this Panel on this issue have any relevance to this dispute? Please elaborate?

1. As Canada noted in its answer to Question 21, the mandatory/discretionary distinction is not relevant in the present proceeding. Nevertheless, assuming that the findings of the *Section 301* panel on the mandatory/discretionary issue are correct, they are supportive of Canada's position in this dispute. As the question notes, the *Section 301* panel found legislation to be presumptively inconsistent with the WTO Agreement in a case where legislation provided discretion to act in a WTO-inconsistent manner.

2. In addition, the *Section 301* panel found, at paragraph 7.96 of its Report, that where legislation is WTO-inconsistent on its face, the fact that a Member can demonstrate that its implementing legislation allows for an application that is consistent with the Member's obligations may not be sufficient to demonstrate that the legislation is in fact consistent with those obligations. However in the present proceeding, Brazil has not even shown that its implementing legislation allows for an application that is consistent with Article 3 of the SCM Agreement.

Q23. What relevance, if any, does the language of Article 3.2 to the SCM Agreement ("A Member shall neither grant nor maintain subsidies referred to in paragraph 1") have to the consideration of PROEX III in this dispute?

1. With respect to the implementation of the recommendations and rulings of the DSB, Brazil's obligation is to withdraw its prohibited export subsidies. At a minimum, this means that Brazil must stop granting or maintaining such subsidies as required under Article 3.2 of the SCM Agreement. Even if Brazil had not actually granted additional prohibited export subsidies under PROEX III, the PROEX III scheme is the legal framework that enables Brazil to continue to grant illegal subsidies. By maintaining the PROEX III scheme, Brazil has failed to stop granting or maintaining prohibited exports subsidies and remains non-compliant with Article 3 of the SCM Agreement.

Q24. Please discuss how, if at all, the concept of minimum premiums as reflected in Article 20 of the 1998 OECD Arrangement applies to interest rate support. Why is interest rate support not identified in Article 20 of the 1998 OECD Arrangement? Are minimum premium benchmarks under the 1998 OECD Arrangement available to non-Participants?

1. When export credits are provided, the final interest rate charged to the borrower is composed of at least two elements: the basic interest rate and a risk premium. Premiums are charged to cover the risk of non-payment by the borrower, i.e., the credit risk.

2. Interest rate support is not mentioned in Article 20 because its provision does not remove the risk of non-repayment by the borrower for the lending institution. This risk can only be assumed when a government provides interest rate support in association with a guarantee or insurance in respect of the credit risk.

3. To ensure that risk is appropriately covered and that a level playing field is established, the Participants to the Arrangement have defined minimum premium benchmarks. Currently, these

benchmarks are not available to non-Participants. Canada supports their disclosure, but any decision to release them requires the consensus of the Participants.

Q25. Please state clearly for the Panel your view regarding which provisions of the 1992 and 1998 Arrangement are "interest rates provisions" within the meaning of the second paragraph of item (k).

1. The following sets out Canada's view of which provisions are pertinent to regional aircraft financing in the 1998 text of the OECD Arrangement would constitute "interest rates provisions" within the meaning of Item (k) of Annex I of the SCM Agreement. The provisions described below affect what the interest rate and the amount of interest payable will be in a given transaction. Within limits, variations of certain of these provisions are permitted under the terms of the Arrangement. Canada notes that provisions in the Arrangement that are pertinent to sectors other than regional aircraft have not been listed. This list is thus without prejudice to Canada's position as far as other sectors are concerned. While Canada has not listed definitional provisions of the Arrangement, those provisions apply to the provisions listed below.

- **Article 2: Scope of Application**

This article restricts the scope of the Arrangement to officially supported export credits with repayment terms of two years or more, and to official support in the form of tied aid.¹⁰

- **Article 3: Special Sectoral Applications and Exclusions**

This article sets out the applicability of special guidelines to certain specific sectors. The guidelines applicable to the aircraft sector provide that in cases where provisions in the Sector Understanding on Export Credits for Civil Aircraft (Annex III) correspond with provisions in the Arrangement, the provisions of the Sector Understanding prevail.

The relevant provisions in the Sector Understanding are Articles 21, 22, 23, 24 and 25 of Annex III, Part 2, which covers new aircraft, and Articles 28, 29, 30 and 31 of Annex III, Part 3, which covers used aircraft, spare engines, spare parts, maintenance and service contracts.

- **Article 7: Cash Payments**

This article requires providers of official support to require purchasers of goods and services to make cash payments of a minimum of 15% of the export contract value of the goods or services, at or before the starting point of a credit (defined in Article 9 of the Arrangement).

- **Article 9: Starting Point of Credit**

This article requires that the repayment term begin by the actual date of delivery. However, depending on the complexity of the underlying export contract, other dates may be applicable.

- **Article 10: Maximum Repayment Term**

This article sets out the maximum term for repayment of the export credit, which can be either five years (with a possible extension to eight and a half), or ten years, depending on whether the recipient country is classified as a Category I or Category II country. (The category of country is determined by World Bank data based on GNP per capita).

¹⁰ Tied aid support is not permitted for civilian aircraft, except for humanitarian purposes (Annex III, Article 24).

- **Article 13: Repayment of Principal**

This article requires that the principle sum of the export credit is normally to be repaid in equal, and at least semi-annual instalments. It also permits equal, blended payments of principal and interest in the case of leases. Within limits, variations are allowed.

- **Article 14: Payment of Interest**

This article requires payments of interest to be made in at least semi-annual instalments during the repayment term. Within limits, variations are allowed.

- **Article 15: Minimum Interest Rates**

This article requires providers of official financing support to apply minimum interest rates, or the relevant Commercial Interest Reference Rates (CIRRs), and sets out the principles by which CIRRs are established.

- **Article 16: Construction of CIRRs**

This article requires CIRRs to be set at a fixed margin of 100 basis points above their respective base rates. For most OECD Participants, the base rates are the yields of government bonds with terms that roughly correspond to the average life of the loan.

- **Article 17: Application of CIRRs**

This article provides that CIRRs can be held for 120 days at an additional cost of 20 basis points. When official financing support is provided for floating rate loans (rather than on a CIRR basis), the Participants must not grant the borrower the option of choosing the lower of CIRR or the short-term market rate throughout the life of the loan.

- **Article 19: Official Support for Cosmetic Interest Rates**

This article forbids the offering of artificially reduced interest rates, which give the borrower the illusion of obtaining more favourable financing terms than are envisaged under the Agreement.

- **Article 21. A): "Premium shall be risk based."**

Paragraph a) of Article 21 requires that premiums be risk-based. This is understood to mean that premiums must "not [be] inadequate to cover long term operating costs and losses" (as provided in Article 22.a)).

- **Article 26: Validity Period for Export Credits**

This article imposes a limit of six months on the length of time offers can remain outstanding for acceptance by the buyer/borrower.

- **Article 29: Matching**

This article permits the offering of terms and conditions that are outside of the Arrangement's rules, but only if such terms and conditions are matching another governments' offer with terms and conditions that are outside of the Arrangement's rules.

- **The 1992 text of the Arrangement**

The interest rate provisions of the 1992 text of the Arrangement that correspond to those listed above are Articles 1, 3, 4, 5, 7(a), 9(d), 11 of the main text including the related definitions; Annex VIII; and Articles 21, 23, 24, 26 of Chapter II of Annex IV, as well as note 6 to that Annex.

Additional Question for Canada

Q31. Please indicate which group(s) or individual(s), other than those identified in your delegation list, have (had) access to Brazil's submissions (including exhibits) and/or statements (including exhibits) in these proceedings. Specifically, have employees or representatives of Canadian regional aircraft manufacturers been given access to such materials? If so, please explain the basis on which you believe that you were entitled to do so under the DSU and the Panel's Working Procedures.

1. Canada has not given access to Brazil's submissions (including exhibits) and/or statements (including exhibits) in these proceedings to any employees of Canadian regional aircraft manufacturers. Canada has shared these documents with members of a private law firm retained by a Canadian regional aircraft manufacturer. These individuals have served as advisors to the Government of Canada and are subject to a confidentiality agreement whereby they are not to disclose documents such as those to which the question refers, including to their client. Moreover, they would not receive any business confidential information had Brazil filed any in this proceeding.

2. As Canada noted in its statement on confidentiality to the Panel, Paragraph 13 of the Working Procedures provides in relevant part:

The parties and third parties shall have responsibility for all members of their delegations and shall ensure that all members of their delegations, *as well as any other advisors consulted by a party or third party*, act in accordance with the rules of the DSU and the working procedures of this Panel, particularly in regard to the confidentiality of the proceedings.

3. Paragraph 13 recognizes that parties may consult advisors who are not members of their delegations. The only reason why parties should have the responsibility for these advisors in regard to the confidentiality of the proceedings is because a party may share submissions and other documents with these advisors. The Appellate Body confirmed this at paragraph 141 of its Report in the original *Canada – Aircraft* proceeding, where it recognized that: "a Member's obligation to maintain the confidentiality of these proceedings extends also to the individuals whom that Member selects to act as its representatives, counsel and consultants."

4. The Panel in *Korea – Taxes on Alcoholic Beverages* also recognized this when it stated in its Report:

We note that written submissions of the parties which contain confidential information may, in some cases, be provided to non-government advisors who are not members of an official delegation at a panel meeting. The duty of confidentiality extends ... to all such advisors regardless of whether they are designated as members of delegations and appear at a panel meeting.¹¹

5. For Brazil to suggest that its submissions may not be shared with a party's advisors who are not on its "delegation" is therefore wrong as a matter of law.

Brazil's position is also entirely arbitrary. According to the Appellate Body, it is for a WTO Member to decide who should represent it as members of its delegation.¹² Although the Appellate Body confined this finding to representation at appellate hearings, there is no logical reason why it should not be extended to other proceedings, and in practice it has been, as the composition of Brazil's delegation at the oral hearing in this proceeding attests. If parties could be deprived of the opportunity to share opposing parties' submissions with those persons most knowledgeable about the trade at issue because they were not "on their delegation", parties would protect their ability to make a full response by greatly expanding their delegations, as is their right.

Additional Question for Both Parties

Q32. With respect to Brazil exhibit 3, please confirm the accuracy of the English translation of Article 3, paragraph 2 of Directive 3.74. In particular, is the phrase "may be extended to" an accurate translation of "poderà ser ampliado, para até?"

1. In Canada's view, the phrase "may be extended to" is *not* an accurate translation of the Portuguese original, "poderà ser ampliado para até". According to the Canadian Government's Multilingual Translation Directorate, an accurate translation of Paragraph 2 of Article 3 is:

The term for the equalization payment, mentioned in the annex hereto, may be extended *for* a maximum of ninety-six months, depending on the unit value of the good at the place of shipment, in accordance with the following schedule: [emphasis added]

2. The difference between "extended *for* a maximum of ninety-six months" and "extended *to* a maximum of ninety-six months" is significant. The former makes clear that the extension is in addition to the term indicated in the annex to Directive 374. The latter could be read to mean that the total term, including an extension, is ninety-six months.

3. Canada's is the only logical translation given the structure of Article 3. Article 3, paragraph 1 provides that the term cannot be greater than (I) the term that was agreed by the exporter (i.e. negotiated in the sales contract) and (II) the maximum term indicated in the annex to Directive 374 under the provisions of paragraph 2 of Article 3 (i.e. the schedule indicating an extension for a maximum of ninety-six months for goods valued in excess of US \$130 thousand) and Article 4. The maximum term for payments for regional aircraft indicated in the annex (per NCM Heading 8802) is 120 months. Accordingly, paragraph 2 of Article 3 cannot be read as limiting financing payments to a total of ninety-six months without creating a conflict with the annex.

¹¹ WT/DS75/R; WT/DS84/R, adopted 17 February 1999, para. 10.32.

¹² *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, WT/DS27/AB/R, adopted 25 September 1997, para. 10.

4. In that regional aircraft can be presumed to have a value in excess of US\$130 thousand, the maximum term for financing payments for regional aircraft in accordance with Directive 374 appears to be 120 months in accordance with the annex which may be extended by an additional 96 months in accordance with paragraph 2 of Article 3. The total term may therefore be up to 218 months, or 18 years.

ANNEX A-5

**CANADA'S COMMENTS ON BRAZIL'S RESPONSES
TO QUESTIONS OF THE PANEL**

(20 April 2001)

I. INTRODUCTION

1. In this submission, Canada offers comments on certain aspects of Brazil's responses to the Panel's questions. In the interest of brevity and because Canada has addressed many of the issues discussed in Brazil's responses in its previous submissions, this submission does not specifically address each response or each element of a response. To this end, Canada relies on its previous submissions. The absence of comments should not be construed as concurrence with a particular response.

II. GENERAL COMMENTS ON BRAZIL'S RESPONSES

1. Brazil's responses to the Panel's questions confirm that PROEX III financing support is a prohibited export subsidy under Articles 1 and 3 of the SCM Agreement, and does not qualify for the safe haven of the second paragraph of Item (k).

2. While there are obvious inconsistencies among individual Brazilian responses to the Panel's questions, taken together, Brazil appears to be asserting that PROEX III payments are subject to two alternative limitations, either one of which, in Brazil's view, automatically assures conformity with the SCM Agreement in all circumstances. However, because PROEX III offers the most favourable of the terms indicated by the market, or the OECD Arrangement, or some combination of the two, it does not ensure conformity with either standard and therefore does not comply with the SCM Agreement. (See Canada's comment on Brazil's response to question 14, below).

3. The first alternative asserted by Brazil seems to be that, regardless of the creditworthiness of the borrower, PROEX III could be provided such that the interest rate to the purchaser is at the CIRR. Brazil seeks to justify such payments, even if they result in the borrower obtaining terms more favorable than those available to the buyer on the market, on grounds that Brazil considers that such terms conform with the exception in the second paragraph of Item (k). Brazil asserts this defense in its response to Questions 14 (e) and (g). However, as Canada has shown, these terms do not conform with the interest rates provisions of the OECD Arrangement.

4. Alternatively, Brazil acknowledges that PROEX III can be provided without regard to the CIRR pursuant to Article 8, paragraph 2 of Resolution 2799, which provides that the Committee administering PROEX shall "have as a reference the financing terms practiced in the international market" when "analyzing received requests for eligibility". Brazil acknowledges that this provision enables the Committee to depart from all of the notional limitations under PROEX III – the CIRR, the ten year term, and the 85 percent financing limit. However, Brazil asserts that "having as reference" the financing terms practiced in the international market means that the Committee must "conform to the financing terms of the international market" when it departs from these limits.

5. Brazil argues that when it has "as reference" the international market, even when the rate is below CIRR and on more favorable terms than under the OECD Arrangement, there is no benefit and thus no subsidy. Brazil does not explain in its responses: (a) how a "reference" to market terms means a requirement to conform with market terms; (b) what it means by the financing terms of the international market; (c) in what sense this precludes the Committee from providing terms to the borrower more favorable than those available to the borrower on the market; or (d) how the

Committee will make this determination. This broad authority is insufficient to demonstrate that PROEX III precludes the Committee from conferring a "benefit" within the meaning of Article 1 of the SCM. Moreover, as Canada has shown, PROEX III confers a benefit *per se*.

6. In response to Questions 2 and 3, Brazil also seems to try to imply that the only subsidy is to the financial institution, not the exported product. However, Brazil's response to Question 4 appears to concede that Brazilian aircraft exports, and not just financial institutions, benefit from these subsidies. Indeed it is difficult to imagine that a country would grant a subsidy simply to benefit foreign banks.

III. COMMENTS ON SPECIFIC RESPONSES

Question 1

1. Brazil's response confirms that the PROEX program has not undergone any revision other than that achieved through BCB Resolution 2799. In its response, Brazil simply re-iterates arguments it has already presented to the Panel regarding the interpretation of Resolution 2799. Canada has responded to those arguments in its prior submissions.

2. In its response, Brazil contends that Article 8, paragraph 2 of Resolution 2799 restricts the provision of PROEX III to terms that are "consistent with the terms practiced in the international market". However, as discussed in Canada's general comments above, Article 8, paragraph 2 does nothing of the sort.

3. Even if Article 8, paragraph 2 did operate as the sort of discipline that Brazil contends it does, restricting the provision of PROEX III payments "consistent with the terms practiced in the international market" is meaningless given the very nature of PROEX payments. As discussed by Canada in its prior submissions, the financing that an Embraer customer would receive from a third-party lender prior to, or in the absence of, PROEX buy-downs is already on market terms. The addition of PROEX III in such circumstances is a *per se* departure from market terms. Canada discusses this in additional detail in its comments on Brazil's response to Questions 2 and 3.

Questions 2 and 3

1. In its response to Questions 2 and 3, Brazil alleges, on the basis of certain hypothetical situations, that PROEX III does not entail a *per se* departure from market terms, and by implication, that there are situations in which PROEX III does not confer a benefit on the purchaser of regional aircraft. Brazil's response is flawed for several reasons:

Brazil Ignores the Character of PROEX Buy-Downs

2. First, the response ignores the fundamental character of PROEX III as well as the character of its predecessor programs as interest rate buy-downs. In and of itself, PROEX III, like PROEX I, is not an export financing program whereby a principal amount is loaned to the recipient conditional on the repayment of the principal plus interest in accordance with the terms of the financing. As stated in paragraph 3 of Canada's First Submission, PROEX payments are direct transfers of funds. They do not have to be paid back. This attribute of PROEX has not changed in PROEX III. PROEX payments are essentially grants. Thus, unlike the case of financing, it is not necessary to compare the terms of PROEX payments to market benchmarks in order to determine whether a benefit has been conferred. Such payments *per se* confer a benefit (equal to the amount of the payment) irrespective of how the payments are used by the recipient.

Brazil's Hypotheticals Are Irrelevant

3. Second, even if Brazil were correct that reference must be made to market benchmarks in order to ascertain the existence of a benefit, Brazil has admitted that under PROEX III it can in any case subsidize interest rates down to the CIRR without regard to the rates being offered by commercial banks. Alternatively, it can "have as reference" the terms practiced in the international market. Neither of those approaches involves limiting the amount of PROEX payments to the difference between what a borrower could obtain elsewhere in the market and the rate at its preferred bank.

Under Brazil's Hypotheticals a Benefit Is Conferred

4. Third, even if the situations identified by Brazil did exist, they would result in a benefit being conferred. The SCM Agreement does not restrict the meaning of "benefit" to a benefit that is purely financial. According to the Appellate Body, a "benefit" exists where the financial contribution makes the recipient "better off" than it would otherwise have been, compared to the marketplace.¹ The purchaser would benefit from a greater choice of banks to handle the transaction than would have been available in the marketplace – what Brazil describes in its first hypothetical situations as "added convenience" for the Embraer purchaser. Finally, in all of the situations described by Brazil, the use of PROEX III would result in Embraer winning a sale that it would not otherwise have received in the marketplace. While PROEX III takes the form of payments to the customer's lending bank, Brazil cannot dispute that Embraer is a beneficiary of the program. The fact that PROEX payments are conditional on the purchase of Brazilian aircraft would be illogical if the purpose of PROEX was simply to assist banks in Brazil and in foreign countries.

5. Furthermore, contrary to Brazil's contention it is simply not the case that in Brazil's first and second hypothetical situations, PROEX would not "place the buyer in any better situation." According to Brazil, if a potential purchaser of regional jets wished to use a Chinese or Brazilian bank for its financing, that bank would be able to offer financing at eight percent with PROEX support, if the purchaser acquired Embraer aircraft. However, Brazil's example ignores that if the same potential purchaser wished to finance a purchase of Canadian aircraft through the same banks (the buyer's preference according to the examples), that purchaser would face a higher interest rate (specified in the second example as ten percent). If a buyer does in fact prefer a Chinese or Brazilian bank, PROEX III therefore would give Embraer a commercial advantage. In both examples, Brazil contends that the resulting terms would be no better than those available in the "international" marketplace, which Brazil defines as certain large lenders outside of China and Brazil. However, this is a semantic sleight-of-hand. The question refers to the terms available in the "commercial" marketplace. The terms otherwise available in the commercial marketplace include those that would be offered by the purchaser's preferred banks in the absence of PROEX buy-downs.

6. Brazil's third hypothetical situation is either not plausible or is a restatement of the first situation. Aircraft financing is made available based on the buyer's credit. If the buyer were able to obtain international financial institution financing at eight percent for the purchase of aircraft from another manufacturer, that buyer could obtain the same financing from that institution for the purchase of Embraer aircraft. There would be no need for PROEX buy-downs to enable Embraer to offer financing at the same rate. If the issue is whether a Brazilian bank could offer financing at the same rate as an international bank, the situation is no different than in the first hypothetical.

Question 4

1. As noted in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III confers benefits on Embraer aircraft, the purchasers of Embraer aircraft and financial institutions. Brazil's response to Question 4 seems to imply, incorrectly, that these are mutually exclusive. However, the

¹ See *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Appellate Body, WT/DS70/AB/R, adopted 20 August 1999, para. 157.

fact that PROEX may benefit foreign banks does not affect or determine whether PROEX confers benefits on Embraer aircraft and their purchasers. In fact, Brazil's response also appears to concede what experience has shown: that PROEX subsidizes exported Embraer aircraft, not just lending institutions.

Question 6

1. In the light of Brazil's ongoing failure to comply with the recommendations and rulings of the DSB in respect of PROEX I and II transactions, it is questionable that the Brazilian Executive has the duty under domestic law to comply with Brazil's WTO obligations. Even if it were the case that the Executive were required to comply with Brazil's WTO obligations as it interprets them, this would offer no more indication of the conformity of PROEX III with Brazil's WTO obligations than it did with respect to PROEX I or PROEX II.

Question 7

1. Brazil contends that PROEX III "addresses the way in which it will, as a matter of law, comply with its WTO obligations." As Canada has shown throughout its submissions in this proceeding, PROEX III does nothing of the sort. Saying it does not make it so.

2. Brazil claims in its response that it meets the "ensure" standard because PROEX III (allegedly) contains specific requirements that are consistent with the OECD Arrangement criteria. Brazil apparently does not contend that it has "ensured" that PROEX III will not confer a benefit, and thus, seems to concede that it is in violation of its obligations under the SCM Agreement unless the Panel finds that PROEX III "ensure[s] that financing under its terms qualifies for the safe haven of the second paragraph of item (k)."

3. However, as Canada demonstrated in its Rebuttal Submission, PROEX III ensures no such thing. PROEX III does not even address many of the interest rates provisions of the OECD Arrangement. Therefore, contrary to Brazil's assertion, PROEX III does not demonstrate that Brazil "will, as a matter of law, comply with its WTO obligations."

4. In its responses to subsequent questions, Brazil acknowledges that it can decide not to comply with the interest rates provisions of the OECD Arrangement, and instead provide financing on other terms "having as reference the financing terms practiced in the international market". As Canada has explained in its comments on Brazil's previous responses, this vague language imposes no disciplines on the terms that Brazil can offer under PROEX III.

Question 8

1. On page 12, paragraph (a), Brazil admits that it can depart from the 85 percent loan to value requirement pursuant to the authority in Article 8.2 of the Resolution "when interest rate support is provided on terms consistent with the international market" (i.e., the loan to value ratio prevailing in the market exceeds 85 percent). It justifies this departure on the basis that PROEX III would not confer a benefit in such circumstances.

2. In Canada's view, this is further evidence that PROEX III does not comply with the interest rates provisions of the OECD Arrangement. As to Brazil's position that PROEX III would not confer a benefit in such circumstances, as noted in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III *per se* confers a benefit in all circumstances.

3. In part (c) of its response, Brazil does not deny that the newspaper reports submitted by Canada accurately report the statements of Foreign Minister Lampreia and Ambassador Graca Lima. Instead, Brazil argues that these statements "do not provide evidence of what PROEX III *actually*

requires." However, given the broad discretion available to the Brazilian Executive when administering PROEX III, statements of how Brazil intends to interpret its law are important to this case. In particular, these statements demonstrate Brazil's intention not to comply with the interest rates provisions of the OECD Arrangement. When considered in the context of the historical application of PROEX and the fact that the most recent amendments to PROEX have not curtailed the discretionary authority of the Brazilian Executive, the probative value of these statements cannot be denied. Brazil has offered nothing to suggest that it will follow its own criteria under PROEX III any more than it followed the same criteria under earlier versions of PROEX, when they had the same status in Brazilian law.

Question 9

1. In parts (a) and (c) of its response, Brazil states that under Article 8, paragraph 2, it may only depart from the eligibility criteria in PROEX III "when interest rate support is provided on terms consistent with the international market". As Canada explained in its general comments and elsewhere, the wording of Article 8, paragraph 2 does not impose any such limitation. However, even if it did, this would mean that Brazil would depart from the ten year maximum when the duration of financing prevailing in the market exceeds 10 years. Again, Brazil claims justification for this departure on the basis that PROEX III would not confer a benefit in such circumstances.

2. However, as noted in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III *per se* confers a benefit in all circumstances. In the light of Canada's evidence that the prevailing terms for financing regional aircraft significantly exceeds 10 years, Brazil's admission that it will waive the 10 year requirement in such circumstances is fatal to its argument that PROEX III complies with the interest rates provisions of the OECD Arrangement and therefore can benefit from the safe haven in the second paragraph of Item (k).

Question 10

1. Even if Brazil has not yet committed to PROEX III financing, this does not assist Brazil in establishing compliance. Since PROEX III *per se* confers prohibited export subsidies that are not saved by any exceptions in the SCM Agreement, it remains inconsistent with a covered agreement within the meaning of Article 21.5 of the DSU.

Question 11

1. With respect to PROEX III's alleged conformity with the specified Articles of the 1998 OECD Arrangement, Canada notes the following:

2. Article 21 of Annex III, which specifies Maximum Repayment Terms for all new aircraft except large aircraft, prevails over Articles 12 and 10 of the main text due to Article 3, also of the main text. PROEX III is inconsistent with Article 21 of Annex III in that it allows for a repayment term in excess of 10 years for regional jet aircraft as Brazil has admitted in its answer to Question 9(a) of the Panel and elsewhere. Furthermore, in Brazil's view the "interest rates provisions" do not include Article 21 (or, *inter alia*, Article 7 of the main text, i.e., requiring cash payments of a minimum of 15% of the export contract value – see Brazil's answer to Question 25 of the Panel). Therefore, Brazil can ignore these Articles and, in its view, still qualify for the safe haven of the second paragraph of Item (k). This is confirmed by Brazil's answer to Question 14(g) of the Panel where Brazil states that it "may approve financing at a net interest rate equal to the CIRR and still qualify for the safe haven" Such a position is erroneous. This requirement is one of the numerous requirements that must be complied with in order for Brazil to invoke the safe haven of the second paragraph of Item (k).

3. Brazil provides incomplete, inaccurate or misleading descriptions of several of the Articles when comparing them to PROEX III:

- Article 13 requires much more than "repayment of principle in regular instalments not less than six months in frequency." Brazil omits that the instalments of principal should normally be equal and that the first instalment shall be made no later than six months after the starting point of credit. The unlimited grace period allowed under Article 2 of Directive 374 is inconsistent with Article 13 in that it allows transactions in which the first payment of principal is made more than six months after the starting point of the credit.
- Article 14 requires much more than "payment of interest on a six-monthly basis." Article 14 specifies that interest shall not normally be capitalized during the repayment period and that the first instalment must be made no later than six months after the starting point of credit. Also, it states that interest excludes: any payment by way of premium or other charge for insuring or guaranteeing supplier credits or financial credits; any other payment by way of banking fees or commissions relating to the export credit other than regular bank charges; and withholding taxes. To the extent that PROEX III is used to buy-down risk premiums, Brazil would not be providing interest rate support as envisaged by the 1998 OECD Arrangement (assuming, *arguendo*, that PROEX III payments are interest rate support).
- Brazil claims that Articles 16 and 17 govern the calculation of the CIRR. This is not the case – Article 17 covers how a country applies the CIRR for a specific transaction and not how it is calculated. Article 17 contains important conditions on how to define the interest rate that is appropriate for a given transaction. It states that the interest rate applying to a specific transaction shall not be fixed for a period longer than 120 days; that if the terms of official financing support are fixed before the contract is signed, a margin of 20 basis points must be added to the CIRR; and that the lender cannot offer the option of the lower of either the CIRR (at the time of the original contract) or the short-term market rate throughout the life of the loan if it is providing a floating rate loan.

Brazil has offered no evidence of conformity with Article 17 and instead attempts to distance PROEX III on the irrelevant basis of non-Participant status. Whether or not a Member is a Participant to the Arrangement is irrelevant to how Article 17 is applied. Given the expansive discretion under PROEX III that is admittedly used on a routine basis, it can only be expected that Brazil would use this discretion in applying Article 17 and waive the 20 basis point margin if it were to apply. A bald statement "that the net interest rate for a PROEX-supported transaction may not be below the CIRR" is wholly insufficient to prove that PROEX III conforms with Article 17. (By the use of the word "may", it appears that Brazil could even use its discretion to go below the CIRR.)

4. Contrary to Brazil's claim, Articles 18 and 19 on Cosmetic Interest Rates are relevant to PROEX III – if PROEX III payments are "interest rate support" within the meaning of the 1998 Arrangement. Article 19(b) states that "official financing support" cannot be offered at a cosmetic interest rate. "Interest rate support" is one of the means that is referred to as "official financing support", as confirmed by the fourth paragraph of the Introduction to the 1998 OECD Arrangement and the first sentence of Article 15 on Minimum Interest Rates. If PROEX III payments are "interest rate support" within the meaning of the 1998 Arrangement, Articles 18 and 19 are relevant to PROEX III because the payments would constitute "official financing support".

5. Brazil cannot claim that PROEX III is in conformity with Article 19 of Annex III on the sole basis that PROEX III "requires a minimum interest rate of the CIRR." Article 19 of Annex III states that "[the provisions of this Chapter represent the most generous *terms* that Participants may offer

when providing official support." [emphasis added]. Respecting the CIRR alone, as Brazil claims, is insufficient to conform with Article 19 of Annex III.

6. As the regional aircraft market matures, it is possible that Brazil could be in a position to market used aircraft in the future. Therefore, Articles 27 and 28 of Annex III would be relevant to PROEX III despite Brazil's claim of irrelevancy. Should Brazil decide to provide PROEX III buy-downs for used aircraft in the future, Brazil must respect these articles to be in conformity with the interest rates provisions of the 1998 OECD Arrangement.

Question 13

1. In practice, the administration of PROEX III on a case-by-case basis is no different from the administration of PROEX II. As described at paragraph 2.3 of the Article 21.5 Panel Report, the resolution establishing PROEX II stated that: "equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices."

2. Thus, the character of PROEX has not been changed. PROEX remains nothing more than a pure grant in the form of an interest rate buy-down. As before, the Committee retains broad discretion to determine the terms of the grant.

Question 14

1. Brazil admits in part (g) of its response to this question that the individual terms (e.g. net interest rate, loan-to-value ratio, financing term, etc.) under which PROEX III is offered, are the more favourable of those indicated by the market or the CIRR. It is not limited by the requirements of the OECD Arrangement. Under PROEX III, the net interest rate offered may be the lowest (i.e. the CIRR) and the loan-to-value ratio and financing term may be the highest (i.e., the market). In such circumstances, PROEX III does not comply with either the market or the OECD Arrangement. This admission therefore undercuts what appear to be Brazil's alternative assertions, as described above under General Comments.

2. This was the factual situation facing Canada in the Air Wisconsin transaction, where as an inducement to purchase Embraer aircraft, Air Wisconsin was offered a net interest rate at the CIRR for a maturity term exceeding 10 years. Brazil's response to Question 1 from Canada that it has "not received an application for interest rate support for sales by Embraer to Air Wisconsin and has not approved any support for this transaction" does not answer the question of whether PROEX III was *offered* in conjunction with that transaction.

3. Canada also notes that parts (a) and (c) of Brazil's responses contradict its response to Questions 2 and 3. Brazil claims in part (a) that the term "international market" refers "to the market in which the product for which PROEX support is requested competes." This would mean, for example, that in a sale by Embraer to a Chinese airline, the relevant "financing terms practiced in the international market" would be those practiced in China. However, according to Brazil's second examples in response to Questions 2 and 3, PROEX III is used, *inter alia*, to buy down interest rates to below those available in China.

4. In part (c) of its response, Brazil asserts that the financing terms practiced in the "international market" refers to "the terms that would be available for a comparable transaction for that buyer in the commercial marketplace." PROEX III does not say this. Moreover, as Canada has noted in its comments on Brazil's response to Questions 2 and 3, in that response Brazil defined the "international" marketplace as certain large lenders outside of the market where its subsidized aircraft are being sold.

5. Thus, not only does Brazil offer no assurances that the interpretation of PROEX III that it advances in response to Question 14 will be followed in practice by the Committee when administering PROEX III, but this interpretation is contradicted by its previous responses.

6. As Canada notes in its General Comments, Brazil asserts in part (e) of its response, that the phrase "shall have as reference" "prevents the Committee from approving financing on terms more favorable than those prevailing in the international market." However, PROEX III does not say this. Rather, it only requires the Committee to have the international market as a "reference." If Brazil has a more restrictive intention, then it needs to revise PROEX again.

7. In this regard, Brazil's argument in part (i) of its response is beside the point. Brazil emphasizes that Article 8, paragraph 2 of Resolution 2799 uses the mandatory verb "shall". However, all that is mandated is that the Committee "shall" use the international market as a "reference". PROEX III does not require the Committee to ensure that any PROEX support does not provide a benefit compared to the terms otherwise available to the particular buyer. Moreover, given that the Committee can go below the market (see Brazil's responses to 14(e) and (g)), this is clearly not a meaningful limitation.

8. Finally, Brazil's response to part (f) of the question assumes that CIRR is an "appropriate" benchmark in all circumstances, including when financing terms exceed those of the OECD Arrangement. Clearly, as demonstrated by Canada, this assumption cannot be supported. Furthermore, in suggesting that the "Committee would have to consider any proposal for financing that deviated from the CIRR," even when another term greatly exceeds the OECD Arrangement (e.g. a 15 year financing term), Brazil implies that the CIRR is not an interest rate "floor", but a "ceiling". Brazil confirms this in its response to part (g) of the question, where it admits that the Committee may approve financing at the CIRR even when financing terms practiced in the international market would indicate an above-CIRR rate.

Question 21

1. Brazil contends (1) that PROEX requires conformity with the SCM Agreement, and (2) even if it does not, it gives the Committee discretion to act in conformity with the SCM Agreement, *i.e.* it does not *require* a violation of the SCM Agreement.

2. As Canada has demonstrated, the authority granted to the Committee under PROEX III does not require conformity with the SCM Agreement any more than it did under PROEX I or II. On the contrary, PROEX III payments necessarily involve a financial contribution by a government, which confers a benefit. They therefore are subsidies. PROEX III payments are contingent upon export performance. They therefore are prohibited export subsidies.

3. In an Article 21.5 proceeding, the complaining Member satisfies its burden if it establishes a *prima facie* case that the defending Member has not complied with its WTO obligations. The evidence submitted by Canada satisfies this burden. Once the complaining Member has satisfied its burden, it is for the defending Member to establish that it is complying with its obligations. In this context, it is not sufficient for the defending Member to demonstrate that it has *discretion* to comply with its obligations. Such discretion does not overcome the existing *prima facie* case of non-compliance, particularly when, as in the present case, the defending Member has admitted that it will use that discretion in a non-compliant manner, it has done so in the past, and there is evidence that it continues to do so. Instead, the defending Member must show that it is *required* to comply with its obligations, in order to overcome the existing *prima facie* case.

4. None of the GATT cases cited by Brazil on the mandatory/discretionary distinction involved a situation where the complaining Member had already established a *prima facie* case that the defending Member's measures violated its obligations. In the absence of such a *prima facie* case,

those GATT panels required the complaining member to show that the defending Member was mandated to violate its GATT obligations. Brazil also attempts to analogize the present proceeding to its challenge of Canada's programs in *Canada – Aircraft*. However, the analogy fails. Those programs involved direct financing. As discussed in Canada's comments on Brazil's response to Questions 2 and 3, PROEX III *per se* confers a subsidy, unlike direct financing which only confers a subsidy in circumstances where the terms of the financing are more favourable than those available for comparable financing in the market.

Question 25

1. In its answer to Question 25, Brazil argues for a narrow interpretation of "interest rates provisions". In response, Canada notes the following:

2. The most logical interpretation of the term "interest rates provisions" includes all provisions that affect what the interest rate and the amount of interest payable will be in a given regional aircraft transaction. This interpretation of "interest rates provisions" flows from the plain meaning of the words. The text of the second paragraph of Item (k) refers to "interest rates provisions" and not simply to "interest rate". Thus, it must refer to more provisions than those that only affect the interest rate itself.

3. If the term "interest rates provisions" were applied to those provisions that only affect the interest rate itself, the benefit of the exception in the second paragraph of Item (k) would be extended to financing transactions that apply the CIRR but that do not abide by any of the other Arrangement disciplines – specifically those provisions that affect the amount of interest payable in a given regional aircraft transaction. A financing transaction that applied a naked interest rate alone – one that is divorced from the other terms and conditions that affect the amount of interest payable, and are generally a part of any financing transaction – could easily circumvent the minimum interest rate rule found in Article 15 of the 1998 OECD Arrangement. Using the CIRR alone would therefore result in allowing transactions that had *effective* interest rates *below* the CIRR to qualify for the second paragraph of Item (k). Any discipline that Articles 1 and 3 of the SCM Agreement provide for export subsidies would be completely negated. The export subsidy floodgates would be opened.

IV. QUESTIONS FROM CANADA TO BRAZIL

Question 1

1. Brazil does not indicate whether PROEX III was "offered" in the transaction nor does it acknowledge seeking Embraer's consent to waiving the confidentiality commitments.

Question 2

1. Again, Brazil does not answer the question, which was motivated by the evidence, as described in Canada's Rebuttal Submission, that Brazil is granting PROEX III subsidies in conjunction with or subsumed into BNDES financing.