

**CANADA – EXPORT CREDITS AND LOAN GUARANTEES  
FOR REGIONAL AIRCRAFT**

**Recourse to Arbitration by Canada  
under Article 22.6 of the *DSU*  
and Article 4.11 of the *SCM Agreement***

**DECISION BY THE ARBITRATOR**

The decision by the Arbitrator on *Canada – Export Credits and Loan Guarantees for Regional Aircraft* is being circulated to all Members, pursuant to the *DSU*. The decision is being circulated as an unrestricted document from 17 February 2003 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/452).



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<i>Argentina – Footwear (EC)</i>	Appellate Body Report, <i>Argentina – Safeguard Measures on Imports of Footwear</i> , WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:I, 515.
<i>Argentina – Textiles and Apparel</i>	Panel Report, <i>Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items</i> , WT/DS56/R, adopted 22 April 1998, as modified by the Appellate Body Report, WT/DS56/AB/R and Corr.1, DSR 1998:III, 1033.
<i>Argentina – Textiles and Apparel</i>	Appellate Body Report, <i>Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items</i> , WT/DS56/AB/R and Corr.1, adopted 22 April 1998, DSR 1998:III, 1003.
<i>Australia – Automotive Leather II (Article 21.5 – US)</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS126/RW and Corr.1, adopted 11 February 2000, DSR 2000:III, 1189.
<i>Brazil – Aircraft (Article 22.6 – Brazil)</i>	Decision by the Arbitrators, <i>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</i> , WT/DS46/ARB, 28 August 2000.
<i>Canada – Aircraft</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.
<i>Canada – Aircraft (Article 21.5 – Canada)</i>	Panel Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU</i> , WT/DS70/RW, adopted 4 August 1999, as modified by the Appellate Body Report, WT/DS70/AB/RW.
<i>Canada – Aircraft Credits and Guarantees</i>	Panel Report, <i>Canada – Export Credits and Loan Guarantees for Regional Aircraft</i> , WT/DS222/R and Corr.1, adopted 19 February 2002.
<i>EC – Bananas III (US) (Article 22.6 – EC)</i>	Decision by the Arbitrators, <i>European Communities – Regime for the Importation, Sale and Distribution of Bananas – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU</i> , WT/DS27/ARB, 9 April 1999, DSR 1999:II, 725.
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<i>EC – Hormones (US) (Article 22.6 – EC)</i>	Decision by the Arbitrators, <i>European Communities – Measures Concerning Meat and Meat Products (Hormones) – Original Complaint by the United States – Recourse to Arbitration by the European Communities under Article 22.6 of the DSU</i> , WT/DS26/ARB, 12 July 1999, DSR 1999:III, 1135.
<i>Norway – Trondheim Toll Ring</i>	Panel Report, <i>Panel on Norwegian Procurement of Toll Collect Equipment for the City of Trondheim</i> , adopted 13 May 1992, BISD 40S/319.
<i>US – FSC (Article 22.6 – US)</i>	Decision by the Arbitrator, <i>United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Arbitration by the United States under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement</i> , WT/DS108/ARB, 30 August 2002.
<i>US – Wool Shirts and Blouses</i>	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323.

## I. INTRODUCTION

### A. INITIAL PROCEEDINGS

1.1 On 19 February 2002, the Dispute Settlement Body (DSB) adopted the report of the Panel in this dispute.<sup>1</sup> The DSB recommended, in particular, that Canada withdraw the subsidies found to be incompatible with its obligations under Article 3.1(a) of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) within 90 days.<sup>2</sup> The 90-day period expired on 20 May 2002.

1.2 On 24 May 2002, Brazil stated that Canada had not followed the recommendation of the DSB within the time-period specified by the Panel and, pursuant to Article 4.10 of the SCM Agreement and Article 22.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Brazil requested the DSB to authorize it to take appropriate countermeasures in the amount of US\$3.36 billion.<sup>3</sup>

1.3 In its communication, Brazil specified, *inter alia*, that it intended to implement this authorization to take appropriate countermeasures in the form of some or all of the following:

- (a) suspension of the application of the obligation under paragraph 6(a) of Article VI of GATT 1994 to determine that the effect of subsidization under EDC Canada Account and EDC Corporate Account programmes is to cause or threaten material injury to an established domestic industry, or is to retard materially the establishment of a domestic industry;
- (b) suspension of the application of obligations under the Agreement on Import Licensing Procedures relative to licensing requirements on imports from Canada; and
- (c) suspension of tariff concessions and related obligations under the GATT 1994 concerning a list of products to be drawn from the list attached to its request.

### B. REQUEST FOR ARBITRATION AND SELECTION OF THE ARBITRATOR

1.4 On 21 June, Canada submitted a communication to the DSB objecting to the recourse by Brazil to Article 22.2 of the DSU and Article 4.10 of the SCM Agreement. Canada stated that the countermeasures proposed by Brazil were not appropriate.

1.5 Furthermore, Canada considered that, with respect to the part of Brazil's request regarding an alleged failure of Canada to withdraw subsidies in respect of certain aircraft options in a transaction considered by the Panel:

- (a) the situation described in Article 22.2 of the DSU had not occurred since there was no subsidy for Canada to withdraw;
- (b) hence, a necessary precondition for the operation of Article 22.6 of the DSU had not been satisfied; and
- (c) the DSB had no authority to consider the authorization requested by Brazil.

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<sup>1</sup> Report of the Panel on *Canada – Aircraft Credits and Guarantees*, hereafter the "Panel" and the "Panel Report".

<sup>2</sup> As recommended in the Panel Report on *Canada – Aircraft Credits and Guarantees*, para. 8.4.

<sup>3</sup> WT/DS222/7.

Canada requested that the item be removed from the agenda of the DSB. Alternatively, Canada requested that the matter be referred to arbitration under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement.<sup>4</sup>

1.6 At the meeting of the DSB on 24 June 2002, it was agreed that the matter raised by Canada in document WT/DS222/8 be referred to arbitration, in accordance with Article 22.6 of the DSU and Article 4.11 of the SCM Agreement.<sup>5</sup>

1.7 The Arbitration was carried out by the original Panel, namely:

Chairman: Prof. William J. Davey  
Members: Ms Usha Dwarka-Canabady  
Prof. Seung Wha Chang.

1.8 The Arbitrator held an organization meeting with the parties on 17 July 2002, during which the parties expressed their views on the draft timetable and working procedures prepared by the Arbitrator. Having regard to additional comments subsequently submitted by the parties, the Arbitrator adopted its timetable and working procedures on 25 July 2002.<sup>6</sup> According to the timetable, Brazil submitted a statement of its methodology to establish appropriate countermeasures on 3 September 2002. Canada submitted comments on 10 September. Both parties filed initial written submissions on 20 September and rebuttal submissions on 8 October. The Arbitrator held a substantive meeting with the parties on 24 October 2002 and submitted written questions to the parties on 25 October. The parties replied in writing on 1 November 2002 and were given until 7 November to comment on each other's replies. Thereafter, both parties requested the Arbitrator not to issue its report between 6 December and 19 December 2002. A confidential version of the report of the Arbitrator was issued to the parties on 23 December 2002. Parties were requested to identify, by 6 January 2003, those portions of the report which, in their view, should remain confidential. After having received comments from the parties, the Arbitrator circulated the non-confidential version of the report to Members on 17 February 2003.

## II. PRELIMINARY ISSUES

### A. MANDATE OF THE ARBITRATOR

2.1 Canada has initiated these proceedings pursuant to Article 22.6 of the DSU and Article 4.11 of the SCM Agreement. Article 22.6 of the DSU provides in relevant part:

"When the situation described in paragraph 2 occurs, the DSB, upon request, shall grant authorization to suspend concessions or other obligations within 30 days of the expiry of the reasonable period of time unless the DSB decides by consensus to reject the request. However, if the Member concerned objects to the level of suspension proposed, (...) the matter shall be referred to arbitration. (...)"

2.2 However, with regard to countermeasures taken in response to violations of Article 3.1 of the SCM Agreement on prohibited subsidies, Article 4.11 of that Agreement provides the following mandate for Arbitrators:

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<sup>4</sup> WT/DS222/8.

<sup>5</sup> WT/DS222/9.

<sup>6</sup> The Arbitrator's Working Procedures are found in Appendix 3 of the DSU and Annex 2 to this report.



"In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding ('DSU'), the Arbitrator shall determine whether the countermeasures are appropriate."

2.3 Canada argues that the level of suspension of concessions requested by Brazil is inconsistent with Article 4.10 of the SCM Agreement in that the countermeasures proposed are not "appropriate" within the meaning of that provision.

2.4 We note that Canada has raised no issue regarding the *type* of countermeasure proposed in this case. Our mandate under Article 4.11 of the SCM Agreement in relation to the violation of Article 3 of that Agreement is therefore only to determine whether the *level* of countermeasures proposed is appropriate.

## B. BURDEN OF PROOF

2.5 Both parties agree that Canada, as the applicant in this case, bears the burden of proving its assertions that the requested level of suspension of concessions is not an appropriate countermeasure within the meaning of Article 4.10 of the SCM Agreement.<sup>7</sup>

2.6 We recall that the general principles applicable to burden of proof, as stated by the Appellate Body, require that a party claiming a violation of a provision of the WTO Agreement by another Member must assert and prove its claim.<sup>8</sup> We find these principles to be also of relevance to arbitration proceedings under Article 4.11 of the SCM Agreement.<sup>9</sup> In this procedure, we thus agree that it is for Canada, which has challenged the consistency of Brazil's proposed level of countermeasures under Articles 4.10 of the SCM Agreement, to bear the burden of proving that the proposed amount is not consistent with that provision. It is therefore up to Canada to submit evidence sufficient to establish a *prima facie* case or "presumption" that the countermeasures that Brazil proposes taking are not "appropriate". Once Canada has done so, it is for Brazil to submit evidence sufficient to rebut that "presumption". Should the evidence remain in equipoise on a particular claim, the Arbitrator would conclude that the claim has not been established.

2.7 We note, however, that it is generally for each party asserting a fact, whether complainant or respondent, to provide proof thereof.<sup>10</sup> In this respect, therefore, it is also for Brazil to provide evidence for the facts which it asserts.

2.8 Finally, both parties have claimed that, in respect of certain issues, the other party is in sole possession of the information necessary to establish the appropriateness of the proposed level of suspension of concessions or other obligations. In this regard, we recall that both parties generally have a duty to cooperate in these arbitral proceedings in order to assist us in fulfilling our mandate, through the provision of relevant information.<sup>11</sup> This is why, even though Canada bears the original burden of proof, we also requested Brazil to submit a "methodology paper" describing how it arrived at the level of countermeasures it proposes.<sup>12</sup> Later, we asked it to come forward with evidence supporting various factual assertions made in its "methodology paper".

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<sup>7</sup> Brazil first submission, paras. 22-24; Canada rebuttal submission, paras. 12-15.

<sup>8</sup> Report of the Appellate Body, *US – Wool Shirts and Blouses* DSR 1997:I, 323, at 337.

<sup>9</sup> For previous application of these rules in arbitration proceedings under Article 22.6 of the DSU, see Decision by the Arbitrators, *EC – Hormones (Canada)* (Article 22.6 – EC), paras. 8 ff. For an application in the context of Article 4.11 of the SCM Agreement, see Decision by the Arbitrators, *Brazil – Aircraft*, (Article 22.6 – Brazil), paras. 2.8 ff; Decision by the Arbitrator, *US – FSC* (Article 22.6 – US), paras. 2.8-2.11.

<sup>10</sup> Report of the Appellate Body, *US – Wool Shirts and Blouses*, p. 335.

<sup>11</sup> Report of the Appellate Body, *Canada – Aircraft*, para. 190.

<sup>12</sup> This approach is similar to those followed in all other arbitrations under Article 22.6 of the DSU and under Article 4.11 of the SCM Agreement.

C. TREATMENT OF EVIDENCE SUBMITTED BY BRAZIL IN ITS CLOSING STATEMENT AT THE HEARING

2.9 Canada claims that Brazil submitted new arguments and new evidence in its concluding remarks at the end of our substantive meeting with the parties, held on 24 October 2002.<sup>13</sup> The evidence at issue consisted of two press articles contained in Exhibits BRA-76 and 77. Canada argues that Brazil's submission of those exhibits was in breach of due process and contrary to the provisions of paragraph (d) of the Arbitrator's Working Procedures<sup>14</sup>, because Brazil gave no reasons why it could not have submitted its evidence in a timely manner. On that ground, Canada requests the Arbitrator to exclude the above-mentioned exhibits.

2.10 Brazil replies that its closing statement was simply a summation of Brazil's case, with some general policy points appended. Regarding Exhibits BRA-76 and 77, Brazil contends that they are properly on the record, being part of Brazil's response to question No. 2 of the Arbitrator to both parties.

2.11 We recall that paragraph (d) of our Working Procedures provides that:

"(d) the parties shall submit all factual evidence to the Arbitrators no later than the first written submissions to the Arbitrators, except with respect to evidence necessary for purposes of rebuttals or answers to questions. Exceptions to this procedure will be granted upon a showing of good cause. In such cases, the other party shall be accorded a period of time for comment, as appropriate;"

2.12 The purpose of paragraph (d), which is also found, *mutatis mutandis*, in most panel and Article 21.5 DSU compliance panel working procedures, is to ensure that parties are given sufficient opportunities to comment on any piece of evidence submitted in the course of the proceedings. Paragraph (d) clearly states the circumstances in which evidence may be submitted after the first written submission. First, additional evidence may be submitted for the purpose of rebuttals or answers to questions. Second, the Arbitrator may allow new evidence to be submitted at a later time, upon a showing of good cause. In all events, paragraph (d) requires that the other party shall be accorded a period of time for comment, as appropriate.

2.13 We recall that in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel and Other Items*<sup>15</sup>, the Panel was confronted with a situation of evidence submitted late in the proceedings.<sup>16</sup> The Panel considered that due process required that it accept the evidence submitted by the United States on the understanding that Argentina would have a period of time to provide further comments on the additional pieces of evidence. The Appellate Body upheld the Panel's reasoning, confirming that the Panel enjoyed a certain amount of discretion in its dealing with evidence and stating that Argentina had not requested more time to comment.<sup>17</sup>

2.14 In this case, Canada requests that the Arbitrator reject the evidence, since Brazil showed no good cause for submitting late a piece of information that had been available to it for some time.<sup>18</sup> Brazil responds that Exhibits BRA-76 and 77 were submitted as part of its reply to question No. 2 of the Arbitrator to both parties. However, nowhere do we find any reference to these exhibits in Brazil's reply of 1 November 2002. Assuming the evidence was for purposes of rebuttal, we see no

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<sup>13</sup> "Canada's Comments on the New Arguments and Evidence in Brazil's Closing Statement", 1 November 2002, paras. 1-3.

<sup>14</sup> Annex 2 to this report.

<sup>15</sup> Panel Report, *Argentina – Textiles and Apparel*, para. 6.55.

<sup>16</sup> In that case, evidence had been submitted by the United States a few days before the second hearing of the panel.

<sup>17</sup> Appellate Body Report, *Argentina – Textiles and Apparel*, paras. 80-81.

<sup>18</sup> Exhibits BRA-76 and 77 are respectively dated 10 July 2001 and 19 October 2002.

particular reason why it could not have been submitted together with Brazil's oral statement at our meeting rather than with its closing statement. By delaying the presentation of this evidence until its closing statement, Brazil's position as respondent gave it a procedural advantage since it spoke last, and it was not foreseen in the Working Procedures that Canada could reply at that point. This makes such a late submission of evidence even less acceptable. Intentionally submitting evidence at a time where the other party is normally no longer in a position to comment – as in this case – not only adversely affects the interests of that party, it also affects due process in general and can generate delays in the work of panels and Arbitrators, thus making it more difficult for them to meet the deadlines contained in the WTO Agreement. Hence, we felt it more appropriate to exclude such evidence rather than to allow Canada to respond, the more so as Canada had expressly requested the Arbitrator to reject such evidence. As a result, we decided not to take into account the evidence submitted by Brazil in Exhibits BRA-76 and 77.

#### D. ADMISSIBILITY OF NEW ARGUMENTS

2.15 Since we reject the evidence contained in Exhibits BRA-76 and 77, we see no reason to consider the arguments of Canada addressing those exhibits.

2.16 This leaves us with the treatment of Canada's additional submission to the extent it addresses Brazil's concluding remarks at the meeting, separately from Exhibits BRA-76 and 77. This submission should not be treated as a reply to new evidence, but as a new submission of arguments which is not foreseen in the Working Procedures. A strict interpretation of our Working Procedures should lead us to disregard Canada's additional submission. However, we note that Brazil developed a rather new line of argumentation in its concluding remarks. It was in the interest of due process and of the information of the Arbitrator to hear what Canada had to say about it, if it wished to do so. We also note that, even if Canada decided to reply to Brazil's arguments, Brazil's right – as respondent – to speak last was preserved by the opportunity given to parties to comment on each other's replies to the questions of the Arbitrator. We saw no reason to formally intervene in that process as long as due process was ultimately respected. We also do not believe that our passivity in this respect could lead to an endless exchange of arguments since the comments on the replies to the questions were the last opportunity for parties to express their views, as provided by the Arbitrator at its hearing with the parties.

2.17 For these reasons we decide to accept Canada's comments on Brazil's concluding statement and Brazil's remarks on those comments.

#### E. CONFIDENTIALITY

2.18 Both parties insisted in the course of the proceedings on the confidentiality of certain documents provided to the Arbitrator.<sup>19</sup> We were mindful of the serious problems that could be caused by the disclosure of certain commercial or financial information. Like the *Brazil – Aircraft* Arbitrator, we were also aware of the fact that the full cooperation of Members and private persons in the WTO dispute settlement mechanism, which is essential for an objective assessment of the facts, often depends on the appropriate protection of confidential information.

2.19 This is the reason why we decided to prepare two versions of this report. The first version, including the details of our calculations and all the information relied upon, was issued exclusively to the parties on a confidential basis. We also requested the parties to identify the commercially sensitive information which they considered should be removed from the text of a non-confidential

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<sup>19</sup> At our request, the parties consented that we could have access to the file of the Arbitrator in *Brazil – Aircraft*, provided we respected the confidentiality of the information contained therein. We made that request in light of the parties' extensive references to the record of that arbitration.

version to be circulated to Members.<sup>20</sup> While some data is not included in this version, it is nevertheless sufficiently detailed for all Members to understand the reasoning of the Arbitrator and the methodology applied in determining whether the countermeasures proposed by Brazil are appropriate. By doing so, the Arbitrator is of the view that it has respected its obligations under the DSU while appropriately protecting the confidentiality of certain information, which had been so requested by the parties.

### III. DETERMINATION OF THE "APPROPRIATE COUNTERMEASURES"

#### A. MAIN ARGUMENTS OF THE PARTIES

3.1 Brazil argues that, given the circumstances of this case, the appropriate level of countermeasures should be set in light of the sales that Brazil (i.e., Embraer) lost to Bombardier in connection with the transactions for which the Panel found that Canada had provided prohibited export subsidies. In order to calculate that amount, Brazil first adds together the value of all the contracts that were won by Bombardier as a result of the subsidies granted by the Canadian Government, i.e. the contracts with Comair, Air Nostrum and Air Wisconsin. Brazil calculates an estimated value of each aircraft under those contracts on the basis of the total value of the Air Wisconsin contract mentioned in a press release by Bombardier on 16 April 2001. Brazil adds to this amount the harm caused to Embraer in the form of lost business opportunities directly related to the transactions that the Panel established were inconsistent with the SCM Agreement, i.e., supply of parts and services to Air Nostrum, Air Wisconsin and Comair, and sales to other Delta Airlines subsidiaries lost due to fleet "commonality" factors.<sup>21</sup> Brazil considers that the total represents a possible level of "appropriate" countermeasures. However, Brazil considers this amount unnecessarily high, given the magnitude of trade between the two countries. Therefore, Brazil limits the level of its proposed countermeasures to US\$3.36 billion, which is its estimate of the value of the contracts for aircraft not delivered as of the date that the subsidy should have been withdrawn, i.e., 20 May 2002.

3.2 Canada considers that this case is similar to the arbitration in *Brazil – Aircraft*. Accordingly, Canada accepts that it would be appropriate to authorize Brazil to take countermeasures based, as in that arbitration, on the amount of the subsidy. This amount would correspond to the difference between the present value of the payments due under the subsidized financing on the aircraft delivered or to be delivered after the compliance date, and the value of the payments that would have been due if those aircraft were financed at market rate.<sup>22</sup> Canada argues that the use of the sales value rather than the amount of the subsidy would result in inappropriate countermeasures, claiming that there is no reason to depart from the approach used by the other Article 4.11 Arbitrators. Moreover, according to Canada, Brazil has not demonstrated that the sales value equates to the "harm" allegedly arising from the Air Wisconsin transaction. Canada argues that Brazil simply assumes that, were it not for Canada's subsidy, Embraer would have won the entirety of the sales and options won by Bombardier with Air Wisconsin.<sup>23</sup> Canada considers that a more proper approach would be to use a counterfactual scenario in which Canada would have withdrawn the subsidy as of 20 May 2002. Canada considers that, leaving aside financing conditions, there was a margin of preference for

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<sup>20</sup> Canada submitted proposals for redaction on 6 January 2003. On 13 January 2003, Brazil objected to a number of redactions proposed by Canada. In a response dated 22 January 2003, Canada agreed that the redactions objected to by Brazil were not necessary. Thus, the text of the version circulated to Members is identical to the text of the confidential version issued to the parties, with the exception of the information which the Arbitrator, having regard to the comments of the parties, considered to be confidential. This information is replaced by "xxx".

<sup>21</sup> Brazil adds that it did not include in its calculations lost tax revenue due to lost sales and other material losses, such as those resulting from direct and indirect unemployment and losses of parts and services suppliers, among others (Brazil's methodology paper, third page).

<sup>22</sup> Canada's comments on Brazil's methodology paper, paras. 3-4.

<sup>23</sup> Canada rebuttal submission, paras. 42-48.

Bombardier, which must be added on top of the cost for Air Wisconsin of switching its remaining orders to Embraer. Canada believes that the overall cost of the switch would have been higher than any potential financial benefits. Moreover, any realistic counterfactual scenario must include consideration of the compelling interest of the supplier to respond by assuming some of the terms of the contract. On that basis, Canada is of the view that the only reasonable conclusion is that the airline would not switch suppliers. Thus, the level of harm in such a counterfactual would be zero.

## B. APPROACH OF THE ARBITRATOR

3.3 We recall that Article 4.10 of the SCM Agreement provides as follows:

"In the event the recommendation of the DSB is not followed within the time-period specified by the panel, which shall commence from the date of adoption of the panel's report or the Appellate Body's report, the DSB shall grant authorization to the complaining Member to take appropriate<sup>9</sup> countermeasures, unless the DSB decides by consensus to reject the request."

*(footnote original)*<sup>9</sup> This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

3.4 In addition, Article 4.11 of the SCM Agreement defines our mandate as follows:

"In the event a party to the dispute requests arbitration under paragraph 6 of Article 22 of the Dispute Settlement Understanding ('DSU'), the Arbitrator shall determine whether the countermeasures are appropriate.<sup>10</sup>"

*(footnote original)*<sup>10</sup> This expression is not meant to allow countermeasures that are disproportionate in light of the fact that the subsidies dealt with under these provisions are prohibited.

3.5 These two provisions complement each other: The expression "appropriate countermeasures" defines what measures can be authorized in case of non-compliance, and our mandate requires us to review whether, in proposing certain measures to take in application of that provision, the prevailing Member has respected the parameters of what is permissible under Article 4.10 of the SCM Agreement. In doing this, we must aim at determining whether, in this particular case, the countermeasures proposed by Brazil are "appropriate".

## C. THE NOTION OF "APPROPRIATE COUNTERMEASURES" UNDER ARTICLE 4.10 OF THE SCM AGREEMENT

3.6 Our first task is to consider the meaning of Article 4.10 to the extent necessary for this arbitration. In relation to this, we note that the parties have made frequent references to the other two arbitrations carried out so far under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement: *Brazil – Aircraft* and *US – FSC*. We note that in both cases (and, in particular, the *US – FSC* case) the Arbitrators had to examine the provisions of Article 4.10 and, in particular, the term "appropriate countermeasures". We recall that both Arbitrators applied for that purpose the general principles of interpretation as embodied essentially in Articles 31 to 33 of the Vienna Convention on the Law of Treaties (1969).<sup>24</sup>

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<sup>24</sup> See Decision by the Arbitrators, *Brazil – Aircraft (Article 22.6 – Brazil)*, para. 3.42 *et seq.*, Decision by the Arbitrator *US – FSC (Article 22.6)*, para. 4.7, in relation to the application of Article 3.2 of the DSU and the Vienna Convention on the Law of Treaties to arbitrations under the DSU.

3.7 We note that the Arbitrator in *US – FSC* first considered the meaning of the term "countermeasures":

"5.4 Dictionary definitions of 'countermeasure' suggest that a countermeasure is essentially defined by reference to the wrongful action to which it is intended to respond. The New Oxford Dictionary defines 'countermeasure' as 'an action taken to counteract a danger, threat, etc'.<sup>25</sup> The meaning of 'counteract' is to 'hinder or defeat by contrary action; neutralize the action or effect of'<sup>26</sup>. Likewise, the term 'counter' used as a prefix is defined *inter alia* as: 'opposing, retaliatory'<sup>27</sup>. The ordinary meaning of the term thus suggests that a countermeasure bears a relationship with the action to be counteracted, or with its effects (cf. 'hinder or defeat by contrary action; neutralize the action or effect of'<sup>28</sup>)."

Considering these definitions in the context of Article 4 of the SCM Agreement, the Arbitrator in *US – FSC* found that the ordinary meaning of the term "countermeasures" includes actions directed either at countering the measure at issue (effectively neutralising the export subsidy), or at countering its effects on the affected party, or both.<sup>29</sup>

3.8 Then, examining the meaning of the term "appropriate", the Arbitrator in *US – FSC* noted:

"5.9 The ordinary dictionary meaning of the term 'appropriate' refers to something which is 'especially suitable or fitting'.<sup>30</sup> 'Suitable', in turn, can be defined as 'fitted for or appropriate to a purpose, occasion...'<sup>31</sup> or 'adapted to a use or purpose'.<sup>32</sup> 'Fitting' can be defined as 'of a kind appropriate to the situation'.<sup>33</sup>"

On the basis of these considerations, it concluded:

"Based on the plain meaning of the word, this means that countermeasures should be adapted to the particular case at hand. The term is consistent with an intent not to prejudge what the circumstances might be in the specific context of dispute settlement in a given case. To that extent, there is an element of flexibility, in the sense that there is thereby an eschewal of any rigid *a priori* quantitative formula. But it is also clear that there is, nevertheless, an objective relationship which must be absolutely respected: the countermeasures must be suitable or fitting by way of response to the case at hand."<sup>34</sup>

3.9 Moving to analyse the meaning of "appropriate" in light of the terms of the attached footnote 9, the *US – FSC* Arbitrator concluded that the flexibility ensured by the use of the term "appropriate" was bound by a requirement to avoid disproportion between the proposed countermeasures and either the actual violating measure itself, the effects thereof on the affected Member, or both.<sup>35</sup> The footnote and the fact that the subsidy has to be withdrawn also make clear that the text of Article 4.10 cannot be construed to confine the appropriateness test to the element of countering the injurious effects on a party. In the view of the *US – FSC* Arbitrator:

<sup>25</sup> (footnote original) The New Shorter Oxford English Dictionary (1993).

<sup>26</sup> (footnote original) *Ibid.*

<sup>27</sup> (footnote original) Webster's New Encyclopaedic Dictionary (1994).

<sup>28</sup> (footnote original) The New Shorter Oxford English Dictionary (1993).

<sup>29</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.6.

<sup>30</sup> (footnote original) Webster's New Encyclopaedic Dictionary (1994).

<sup>31</sup> (footnote original) The New Shorter Oxford English Dictionary (1993).

<sup>32</sup> (footnote original) Webster's New Encyclopaedic Dictionary (1994).

<sup>33</sup> (footnote original) Webster's New Encyclopaedic Dictionary (1994).

<sup>34</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.12.

<sup>35</sup> *Ibid.*, para. 5.19.

"the entitlement to countermeasures is to be assessed in light of the legal status of the wrongful act and the manner in which the breach of that obligation has upset the balance of rights and obligations as between Members. It is from that perspective that the judgment as to whether countermeasures are disproportionate is to be made."<sup>36</sup>

In particular, the Arbitrator recalled that the relative proportion which should exist between the wrongful act and the countermeasures implies that there be "no manifest imbalance or incongruity".<sup>37</sup>

3.10 Considering the SCM Agreement as part of the context of Article 4.10, the Arbitrator in *US – FSC* noticed that the concept of "trade effect", "adverse effect" or "trade impact" was absent from Article 4, whereas such a concept is clearly found in the context of remedies under Article 7 of the SCM Agreement.<sup>38</sup> It concluded that the different terminology reflects the distinct legal nature and treatment of various types of subsidies.<sup>39</sup> The Arbitrator also noted the difference between Article 22.4 of the DSU and 4.10 of the SCM Agreement, remarking that Article 4.10 did not contain the explicit quantitative benchmark found in Article 22.4, which provides that the "level of suspension of concessions or other obligations authorized by the DSB shall be equivalent to the level of nullification or impairment."<sup>40</sup>

3.11 Finally, considering the object and purpose of the SCM Agreement and of the WTO Agreement, the *US – FSC* Arbitrator expressed the view that the objective of the SCM Agreement in relation to Article 4.10 was to secure compliance with the DSB recommendation to withdraw the subsidy without delay.<sup>41</sup>

3.12 The Arbitrator in *US – FSC* concluded:

"5.61 Thus, as we interpret Article 4.10 of the *SCM Agreement*, a Member is entitled to act with countermeasures that properly take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question. This cannot be reduced to a requirement that constrains countermeasures to trade effects, for the reasons we have set out above.

5.62 At the same time, Article 4.10 of the *SCM Agreement* does not amount to a blank cheque. There is nothing in the text or in its context which suggests an entitlement to manifestly punitive measures. On the contrary, footnote 9 specifically guards us against such an unbounded interpretation by clarifying that the expression 'appropriate' cannot be understood to allow 'disproportionate' countermeasures. (...) Countermeasures under Article 4.10 of the *SCM Agreement* are not even, strictly speaking, obliged to be proportionate but not to be 'disproportionate'. Not only is a Member entitled to take countermeasures that are tailored to offset the original wrongful act and the upset of the balancing of rights and obligations which that wrongful act entails, but in assessing the 'appropriateness' of such countermeasures – in light of the gravity of the breach – , a margin of appreciation is to be granted, due to the severity of that breach."

3.13 Having regard to the reasoning of the Arbitrator in *US – FSC*, we consider that the terms of Article 4.10, taken in their context and in the light of the object and purpose of the SCM Agreement

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<sup>36</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.24.

<sup>37</sup> *Ibid.*, para. 5.18.

<sup>38</sup> *Ibid.*, paras. 5.32-5.33.

<sup>39</sup> *Ibid.*, paras. 5.36-5.37.

<sup>40</sup> *Ibid.*, paras. 5.47-5.48.

<sup>41</sup> *Ibid.*, paras. 5.52-5.53.

and of the WTO Agreement, do not exclude recourse *a priori* to either of the methodologies suggested by the parties in this case. Of particular importance, in our opinion, is the element recalled by the Arbitrator in *US – FSC* that "the countermeasures must be suitable or fitting by way of response to the case at hand."<sup>42</sup>

3.14 In light of the foregoing, in this case we must determine whether the proposed countermeasures are appropriate under Article 4.10 of the SCM Agreement. In doing so, we must ensure that they are not disproportionate.

#### D. ASSESSMENT OF THE LEVEL OF COUNTERMEASURES PROPOSED BY BRAZIL

##### 1. Introduction

3.15 As noted above, Brazil has requested authorization from the DSB to impose countermeasures in an amount of US\$3.36 billion, which is its estimate of the value of the contracts for aircraft not delivered as of the date that the subsidies at issue should have been withdrawn, i.e., 20 May 2002. In fact, that amount includes all aircraft under the Air Wisconsin contract, since Brazil has no information as to the actual deliveries under that contract.

3.16 While Canada concedes that countermeasures based on the amount of the subsidy it granted, subject to certain adjustments, would be appropriate in this case, it argues that Brazil's proposed level of countermeasures is inappropriate. In the first instance, Canada argues that this dispute is very similar to the dispute in *Brazil – Aircraft*<sup>43</sup> and that, compared to that case, the level of the proposed Brazilian countermeasures is disproportionate. Second, Canada argues that a proper analysis of Brazil's proposal, to the extent it is based on lost sales or competitive harm, would lead to the conclusion that no countermeasures are appropriate.

3.17 As noted above<sup>44</sup>, since Canada has challenged the appropriateness of Brazil's proposed countermeasures, it bears the burden of proof in the first instance. Therefore, we start with Canada's argument that proper analysis of Brazil's lost sales/competitive harm methodology establishes that no countermeasures are appropriate.

##### 2. Brazil's lost sales/competitive harm methodology

###### (a) Arguments of the parties

3.18 Canada argues that Brazil "has simply assumed in its argument that, were it not for Canada's subsidy, Embraer necessarily would take the entirety of the Air Wisconsin sales and options won by Bombardier."<sup>45</sup> Canada suggests that the appropriate approach is to examine the counterfactual situation in which Canada would have withdrawn the subsidy on undelivered aircraft as of 20 May 2002, as recommended by the DSB. Canada argues that Air Wisconsin would not have shifted its orders to Embraer because it has a "revealed margin of preference" for Bombardier aircraft, as demonstrated by the fact it chose Bombardier in the first place when faced with "equivalent and competing below-market offers."<sup>46</sup> That preference would have to be added to the costs that Air Wisconsin would incur in switching suppliers in mid-contract. Even if those considerations were not sufficient for Air Wisconsin to remain with Bombardier, Canada argues that Bombardier would have powerful incentives to try to retain Air Wisconsin's business.

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<sup>42</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.12.

<sup>43</sup> See para. 3.2, above.

<sup>44</sup> See para. 2.6, above.

<sup>45</sup> Canada rebuttal submission, para. 42.

<sup>46</sup> Canada rebuttal submission, para. 44.



3.19 In response, Brazil argues that Canada's counterfactual is irrelevant because in a prohibited export subsidy case, serious prejudice and adverse effects are presumed.<sup>47</sup> Moreover, Brazil argues that Canada's position that Air Wisconsin had a preference of some sort for Bombardier is inconsistent with Canada's decision to grant a Canada Account subsidy to enable Bombardier to win the contract in the first place.<sup>48</sup> In that regard, Brazil recalls that Canada Account is reserved for transactions involving the national interest, and it also quotes Canadian officials to the effect that the subsidy was necessary to enable Bombardier to win the contract.

(b) Analysis of the Arbitrator

3.20 At the outset, we note that, in principle, countermeasures based on trade effects or competitive harm may be consistent with Article 4.10. However, regardless of whether adverse effects are presumed to exist in a prohibited export subsidy case, as argued by Brazil, the question remains as to whether Brazil's methodology results in a level of countermeasures that is appropriate. Since Brazil bases its proposed countermeasures on trade effects or competitive harm, we must in the first instance determine the nature of the trade effects or competitive harm.

3.21 In past cases where a lost sales or a trade effect methodology was proposed, such as in the *EC – Bananas* and *EC – Hormones* cases, the "level of suspension of concessions" (the equivalent in Article 22 of the DSU of "countermeasures" in Article 4.10 of the SCM Agreement) to be authorized was set by the Arbitrators through a determination of the level of nullification or impairment as of the date that the reasonable period of time for implementation of DSB recommendations expired.<sup>49</sup> The level of nullification or impairment was assessed in light of the relevant measures or markets as of the expiration of the reasonable period of time. Thus, in the *EC – Bananas* cases, the Arbitrators considered the level of the nullification or impairment arising from the revised EC measure<sup>50</sup>, while in the *EC – Hormones* cases, the Arbitrators considered the market for beef products existing on the implementation date, which had shrunk as a result of various health concerns as compared to the market existing at the outset of the case.<sup>51</sup> In all of these cases, the Arbitrators used a counterfactual approach, comparing the existing situation with that which would have occurred had implementation taken place as of the expiration of the reasonable period of time.

3.22 Following this traditional approach, the key issue in this case is whether the withdrawal of future subsidies by Canada as of 20 May 2002 – i.e. the expiration date of the reasonable period of time in this case – would have resulted in a change in Air Wisconsin's future purchases. In considering Canada's arguments that there would be no change, we examine first its contention that Air Wisconsin had a revealed margin of preference for Bombardier. While such a preference may have existed, Canada has not meaningfully quantified it and we doubt its significance given the fact, noted by Brazil, that Canada felt compelled to grant the subsidies at issue in order to ensure the contract for Bombardier. However, more importantly, Canada argues that Bombardier would have incentives to try to keep the Air Wisconsin contract, even at some cost.<sup>52</sup> Brazil does not respond to this argument.<sup>53</sup>

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<sup>47</sup> Brazil's responses to questions to the parties, para. 47.

<sup>48</sup> Brazil's responses to questions to the parties, para. 50.

<sup>49</sup> Decision by the Arbitrators, *EC – Bananas III (US) (Article 22.6 – EC)*, para. 4.9; *EC – Hormones (Canada) (Article 22.6 – EC)*, para. 37; *EC – Hormones (US) (Article 22.6 – EC)*, para. 38.

<sup>50</sup> Decision by the Arbitrators, *EC – Bananas III (US) (Article 22.6 – EC)*, paras. 4.8 – 4.9; *EC – Bananas III (Ecuador) (Article 22.6 – EC)*, para. 168.

<sup>51</sup> Decision by the Arbitrators, *EC – Hormones (Canada) (Article 22.6 – EC)* para. 37; *EC – Hormones (US) (Article 22.6 – EC)*, para. 38.

<sup>52</sup> It is not clear that the costs to retain the contract would be all that great. Canada also contends that given Air Wisconsin's existing relationship with Bombardier as of 20 May 2002, Air Wisconsin would not have switched suppliers at that point. In this regard, we note that 12 of the 51 firm orders had been delivered as of 20 May 2002. Brazil does not directly respond to this contention. Indeed, Brazil has elsewhere argued in a

3.23 On balance, we conclude that Canada has satisfied its burden of demonstrating that the assumptions underlying Brazil's methodology are not valid. After considering the evidence and arguments of the two parties, we are persuaded that withdrawal of the subsidy would not have resulted in Embraer obtaining the remainder of the Air Wisconsin contract. Thus, we find that application of Brazil's lost sales/competitive harm methodology does not justify the level of countermeasures (US\$3.36 billion) proposed by Brazil. Hence, we find the level of countermeasures proposed by Brazil not to be appropriate in terms of Article 4 of the SCM Agreement.

3.24 This conclusion is buttressed by our belief that it would be inappropriate to base the level of countermeasures on lost sales suffered by Embraer as a result of losing the Air Wisconsin contract in a situation where we have previously found that Embraer's original offer to Air Wisconsin was not a market-based offer itself.<sup>54</sup>

3.25 However, we still have some concerns that the approach we follow here – focusing on what would have happened if compliance had occurred compared to the non-compliance situation – may in some cases result in a lack of effectiveness of countermeasures in achieving compliance. Such cases could include those involving violations of the Agreement on Government Procurement or the SCM Agreement in circumstances *not involving*, as this case did, non-market offers by both parties. Indeed, the inadequacy of GATT-style remedies was discussed in some detail in respect of government procurement in the case on *of Norway – Trondheim Toll Ring*.<sup>55</sup> We see no reason to address this issue in this case. This issue is, however, one that should be dealt with in a case where it is relevant. Here, we believe that the approach we have followed has led to the correct result for this particular case.

3.26 In our view, the foregoing analysis indicates that Brazil's proposed countermeasures based on its trade effects/competitive harm methodology are not appropriate. We note, however, that the parties presented extensive arguments on the question of whether the *level* of those countermeasures was "appropriate", particularly in light of the countermeasures authorized in the *Brazil – Aircraft* case. We turn now to examine that issue.

### **3. The appropriateness of the level of Brazil's proposed countermeasures**

#### **(a) Arguments of Canada**

3.27 Canada considers that Brazil's methodology is inconsistent with the methodologies used in the two previous arbitrations regarding export subsidies, which were based on the amount of the subsidy.<sup>56</sup> The amount proposed by Brazil lacks any proportionality and is therefore not appropriate. In this regard, Canada notes that both this case and the *Brazil – Aircraft* case involve the same parties, the same legal provisions, regional aircraft and export subsidies that reduce the cost of financing those aircraft. The two salient differences highlighted by Canada are that far more aircraft were involved in

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different context in this very proceeding that once an airline buys one type of aircraft, it and related companies are likely to stay with that type of aircraft "because of the well known reality in the airline industry that having 'commonality' of aircraft in a company's fleet greatly reduces maintenance and repair costs." Brazil first submission, para. 46 (original underlining).

<sup>53</sup> In this regard, we note that Canada recalls that Brazil had itself made a similar argument in *Brazil – Aircraft*, where it contended, in considering the reaction of Embraer to a withdrawal of subsidies that "Embraer has a strong business interest in maintaining the goodwill and trust of its customers by ensuring that it fulfils the customers' orders." (Canada rebuttal submission, para. 45, quoting Brazil's written submission in *Brazil – Aircraft*, at para. 56).

<sup>54</sup> Panel Report, paras. 7.147-7.150.

<sup>55</sup> Panel Report adopted on 13 May 1992, BISD 40S/319. We also note that, in *Australia – Automotive Leather II (Article 21.5 – US)*, the Panel took the view that, in the particular circumstances of that case, the withdrawal of a prohibited subsidy implied its reimbursement (see, *inter alia*, paras. 6.46-6.49).

<sup>56</sup> Canada first submission, paras. 8-9.

*Brazil – Aircraft* (1,118) and in that case Brazil offered its subsidies simply to gain an illegal commercial advantage over competing aircraft from other countries while in this case, Canada granted subsidies only to offset what the Panel found to be a below-market offer from Embraer. Despite this, Canada notes that the level of countermeasures proposed by Brazil, on a per-aircraft basis, is 43 times the level authorized in *Brazil – Aircraft*.<sup>57</sup>

3.28 Canada also claims that countermeasures, as recognized by the Arbitrator in *US – FSC*, should be adapted to the particular case at hand. The concept of "appropriateness" implies a consideration of the specific circumstances which, in this case, suggest a less egregious violation by Canada, justifying a lower appropriate level of countermeasures. Canada only came to the aid of its own aircraft industry in reply to an imminent threat that Brazil was going to subsidize certain sales. As acknowledged by the Arbitrator in *US – FSC*, countermeasures should reflect the gravity of the breach and the nature of the upset in the balance of rights and obligations in question. In that context, Canada considers that it would be appropriate to reduce the countermeasures to half the amount of the subsidy.<sup>58</sup>

3.29 Canada contests Brazil's argument that Canada intentionally violated its obligations and that this merits especially severe countermeasures. When Canada offered its financing in the Air Wisconsin transaction, it did so in the belief that matching was permitted under the Item (k) "safe haven" of the illustrative List contained in Annex I to the SCM Agreement. Regarding Brazil's claim of targeting, Canada claims that "matching" necessarily involves targeting a specific transaction of another country. Canada acted on credible evidence that Brazil was offering illegal PROEX subsidies, as acknowledged in the Panel report.<sup>59</sup> Brazil bases its request for "punitive" countermeasures on Canada's decision to honour its contract with Air Wisconsin, whereas Brazil in *Brazil – Aircraft* not only chose to honour its existing contracts, but also made commitments after the compliance deadline on a much larger scale. Given the disparity of the breaches and in the particular circumstances of this case, it would be manifestly unjust to grant Brazil's request for countermeasures at a level vastly higher than that granted in respect of Brazil's own non-compliance in *Brazil – Aircraft*. On the contrary, countermeasures proportionally lower than those awarded to Canada in *Brazil – Aircraft* would be entirely appropriate.<sup>60</sup>

(b) Arguments of Brazil

3.30 In considering whether its proposed countermeasures are appropriate, Brazil recalls that both the *Brazil – Aircraft* and *US – FSC* arbitrations allow the Member authorized to retaliate to choose to base the level of countermeasures on either the level of the subsidy or the effect of the subsidy.<sup>61</sup> For Brazil, it is not relevant that Canada and the EC chose to base their proposed countermeasures on the level of the subsidy in those two cases. Brazil also argues that the *Brazil – Aircraft* arbitration is not controlling as a matter of law, and that the two cases are not similar.<sup>62</sup>

3.31 As to the appropriate level for countermeasures, Brazil notes that in *Brazil – Aircraft*, the Arbitrator determined that a countermeasure was appropriate, *inter alia*, if it effectively induced compliance. Brazil's countermeasures are intended to effectively induce Canada to withdraw the prohibited export subsidy. If the level is too low, Brazil Argues, Canada will have no incentive to withdraw the prohibited subsidy.<sup>63</sup> Brazil also recalls that in the *US – FSC* arbitration, the Arbitrator declared that the countermeasure could be directed either at neutralizing the export subsidy or at

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<sup>57</sup> Canada first submission, para. 7.

<sup>58</sup> Canada first submission, paras. 12-18.

<sup>59</sup> Canada rebuttal submission, paras. 20-27.

<sup>60</sup> Canada rebuttal submission, paras. 28-30.

<sup>61</sup> Brazil rebuttal submission, para. 3.

<sup>62</sup> Brazil rebuttal submission, para. 3.

<sup>63</sup> Brazil rebuttal submission, paras. 16-17.

countering its effect on the affected party. The Arbitrator also said that it would be inappropriate to limit countermeasures to the face value of an export subsidy since in some instances the adverse effect could be manifestly greater.<sup>64</sup> According to Brazil, both the *Brazil – Aircraft* and *US – FSC* arbitrations allow the Member authorized to retaliate to choose to base the level of countermeasures on either the level of the subsidy or the effect of the subsidy.<sup>65</sup>

3.32 Brazil adds that the *US – FSC* Arbitrator also stated that the maintenance of the unlawful export subsidy itself had the effect of upsetting the balance of rights and obligations irrespective of the actual trade effects. Thus, an arbitration must account for both the "gravity of the wrongful act" and the objective of securing withdrawal of a prohibited subsidy.<sup>66</sup> A margin of appreciation should be granted due to the "severity of the breach." In this case, Canada knew and admitted that the subsidies it granted were illegal. Moreover, Canada targeted Brazil. This constitutes a severe breach. In addition, Canada has done nothing to implement the DSB recommendations and rulings and does not intend to comply with them. Canada cannot argue that Brazil's violation in *Brazil – Aircraft* was more serious. PROEX is a general export credit programme. Its application to aircraft was to remedy or offset the unfair advantage that Canada has in export financing, whereas Canada gave direct financing on very generous terms.<sup>67</sup> This justifies countermeasures based on the level of competitive harm suffered by Embraer in losing the Air Wisconsin contract as manifestly appropriate.<sup>68</sup> Brazil notes that in *Brazil – Aircraft*, Canada considered that countermeasures could be appropriately based on the level of competitive harm.

3.33 Brazil adds that the Arbitrator in *US – FSC* found that an "appropriate level of countermeasures" must be adapted to the particular case, i.e. suitable and fitting by way of response and concluded that a proposed level of countermeasures is not "disproportionate" unless it is "manifestly excessive".<sup>69</sup> Brazil argues that it could have proposed a significantly higher level of countermeasures which would not have been disproportionate since it was calculated on the basis of the direct harmful effects on Brazil and Embraer of the Canadian illegal measure.<sup>70</sup> For example, Brazil could have added to the value of the Air Wisconsin's contract those of the Air Nostrum and Comair contracts, as well as the opportunities to supply parts and services during the useful life of the aircraft sold to these companies. However, Brazil chose to request a much lower level of countermeasures, one that is strictly proportional to the value of just one of the contracts won by Bombardier with prohibited subsidies. The level of countermeasures requested by Brazil is therefore clearly not disproportionate and bears a direct relationship with the trade effect of the measure.<sup>71</sup>

(c) Analysis of the Arbitrator

(i) *Introductory remarks*

3.34 Canada's basic argument is that Brazil's proposed countermeasures are inappropriate because they are disproportionate compared to the two prior export subsidy cases where countermeasures were authorized. In particular, it draws a comparison between the level authorized in *Brazil – Aircraft* and that proposed here, where the countermeasures on a per-aircraft basis would be 43 times the level authorized there. Since Canada views its breach in this case as having been less serious than Brazil's breach in *Brazil – Aircraft*, it sees the proposed countermeasures as particularly disproportionate.

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<sup>64</sup> Brazil first submission, paras. 29-33.

<sup>65</sup> Brazil rebuttal submission, para. 3.

<sup>66</sup> Brazil rebuttal submission, para. 6.

<sup>67</sup> Brazil rebuttal submission, paras. 22-27.

<sup>68</sup> Brazil first submission, paras. 35-36; Brazil rebuttal submission, para. 7.

<sup>69</sup> Brazil first submission, paras. 37-38.

<sup>70</sup> Brazil rebuttal submission, para. 14.

<sup>71</sup> Brazil first submission, paras. 50-52.

3.35 Brazil argues that a high level of countermeasures is appropriate in this case because of the need for the countermeasures to induce compliance and because of the gravity of Canada's breach.

3.36 At the outset, it seems clear to us that the fact that the amount of the subsidy was used as a basis for setting the level of countermeasures in *Brazil – Aircraft* and *US – FSC* does not preclude Brazil from using a different basis for its proposed countermeasures. The amount of the subsidy was accepted as the basis for the level of countermeasures in those cases by the prevailing party. However, that is not the case here. Brazil cannot be bound by strategic decisions made by other parties in other cases as to the level of countermeasures they wished to have authorized. Nor is the fact that Brazil accepted the amount of the subsidy approach in *Brazil – Aircraft* legally relevant. Obviously, in that case at that time, it was in Brazil's interest to prefer that approach to the alternative proposed by Canada, which would have resulted in a higher level of countermeasures. That is not to say, however, that Brazil has *carte blanche* in proposing countermeasures. They must be appropriate; they must not be disproportionate.

(ii) *Appropriateness of the proposed countermeasures*

3.37 Regarding this question, we express our agreement with the Arbitrator's findings in *US – FSC* that "countermeasures should be adapted to the particular case at hand."<sup>72</sup> Accordingly, we are authorized to consider the relevant factors constituting the totality of the circumstances at hand in order to determine whether Brazil's proposed countermeasures – at a level of US\$3.36 billion – are appropriate in this particular case.

3.38 In the arguments of the parties, we have discerned five factors that may be relevant in evaluating the appropriateness of the proposed level of Brazilian countermeasures: (i) the level of the proposed countermeasures in light of those authorized in *Brazil – Aircraft*; (ii) the level of the proposed countermeasures in light of the value of imports of goods from Canada into Brazil; (iii) the level of the proposed countermeasures in light of the gravity of the breach; (iv) the level of proposed countermeasures in light of the need to induce Canada to comply with its WTO obligations; and (v) the relevance of whether the countermeasures are not manifestly excessive. In this section, we will examine first whether five such factors are relevant here. If relevant, then we will consider each factor for our assessment of the appropriateness of proposed countermeasures.

a. The countermeasures considered on a per-aircraft basis

3.39 First, as noted by Canada, the level of countermeasures proposed by Brazil, on a per-aircraft basis, is 43 times that authorized in *Brazil – Aircraft*; this despite the fact that the level of subsidy per aircraft is not so dissimilar. The per-aircraft subsidy in this case, as we calculate it below, is approximately 2.5 times the per-aircraft subsidy calculated in *Brazil – Aircraft*.<sup>73</sup> Even if adjusted for the different subsidy levels, the difference in the per-aircraft level of countermeasures is a striking difference – on the order of twenty to one.

3.40 While we have concluded that Brazil is not legally bound to propose the same methodology in this case that Canada accepted in *Brazil – Aircraft*, we believe that a comparison of the result produced by the Brazilian methodology with the result in *Brazil – Aircraft* may be relevant in deciding whether the result of the application of the Brazilian methodology is appropriate. After all, this dispute involves largely the same market and products, the same parties and similar violations of the SCM Agreement, i.e. the use of prohibited export subsidies.

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<sup>72</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.12.

<sup>73</sup> An average amount of subsidy per aircraft in *Brazil – Aircraft* can be calculated by dividing the total subsidies of US\$1.4 billion by the 1118 aircraft involved. See *Brazil – Aircraft (Article 22.6 – Brazil)*, paras. 3.76 and 3.93. We would note that the Embraer aircraft at issue were in part smaller and less expensive than the Bombardier aircraft involved in the Air Wisconsin transaction.

3.41 On an initial view, a strong argument can be made that the large difference in levels of countermeasures on a per-aircraft basis compels the conclusion that Brazil's proposed level of countermeasures is not appropriate in this case. Can it be said that Brazil's proposed countermeasures are "fitting by way of response to the case at hand"<sup>74</sup> if Canada is subjected to much more onerous countermeasures on a per-subsidy/per-aircraft basis than Brazil was in a similar case between these same two parties? Ultimately, however, we find it difficult to conclude on this factor alone that the proposed countermeasures are not appropriate. After all, Canada specifically chose to accept the lower of two levels of countermeasures that it proposed in *Brazil – Aircraft*. The alternative level proposed, but not preferred, by Canada was based on trade effects and was significantly larger (Can\$ 4.7 billion). Nonetheless, the large difference in levels of countermeasures on a per-aircraft basis suggests that Brazil's proposed level of countermeasures may not be appropriate.

b. The countermeasures considered in light of the value of imports of goods from Canada into Brazil

3.42 A second measure of appropriateness is to consider the proposed countermeasures in light of the overall level of trade in goods between the two parties.<sup>75</sup> This seems particularly relevant since the point of the countermeasures is to restrict trade and Brazil has made a request to suspend concessions relating to imports of goods from Canada.<sup>76</sup> In that regard, Canada estimates its exports of goods to Brazil in 2001 amounted to US\$591 million.<sup>77</sup> Brazil estimates the amount at US\$927 million.<sup>78</sup> Thus, the level of the proposed countermeasures would be from three to six times Brazil's annual imports from Canada. This disparity between the level of the proposed countermeasures and the total value of Brazil's imports of goods from Canada is so large that, in our view, it is not "fitting by way of response to the case at hand."<sup>79</sup> We understand that an assessment of proportionality under Article 4.10 of the SCM Agreement normally requires the Arbitrator to examine whether some congruence exists between the countermeasures and the original violating measures.<sup>80</sup> It is also true, however, that the plain meaning of "appropriate" in Article 4.10 suggests that "countermeasures should be adapted to the particular case at hand."<sup>81</sup> While we do not wish to minimize in any way the seriousness of the original violation by the measure at issue, our consideration of this particular fact that authorizing countermeasures would, if applied, halt such a significant proportion of trade in goods between the two parties for several years leads us to find that the level of Brazil's proposed countermeasures may not be appropriate to the circumstances at hand.<sup>82</sup>

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<sup>74</sup> See Decision by the Arbitrator *US – FSC (Article 22.6 – US)*, para. 5.12

<sup>75</sup> Brazil implicitly suggests that countermeasures may not be appropriate in light of the value of trade between the parties, when it states that its initial calculation of the countermeasures at US\$10.2 billion "is unnecessarily high, given the magnitude of trade between the two countries." (Brazil's methodology paper, "step 3").

<sup>76</sup> See WT/DS222/7, point (3), p. 2. We note that Brazil's requests also includes suspension of other obligations (see para. 1.3, above).

<sup>77</sup> Canada's answer to question 1 addressed to both parties.

<sup>78</sup> The difference may be explained by the fact that some goods are transhipped through the United States (see Brazil's answer to question No. 1 of the Arbitrator to both parties, para. 3).

<sup>79</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.12.

<sup>80</sup> See, also, para. 3.49, below

<sup>81</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, para. 5.12.

<sup>82</sup> We are mindful that our consideration of the total value of imports of goods from Canada into Brazil in order to assess appropriateness may be interpreted as creating an imbalance between WTO Members. Members with limited imports would be prevented from imposing a large amount of countermeasures, whereas Members with significant imports would be entitled to a larger amount of countermeasures. We do not believe that our decision creates that imbalance or exacerbates inequalities in a system based on countermeasures in the form of suspensions of concessions or other obligations under the WTO Agreement. Rather, our decision simply reflects the imbalance between Members that inherently results from the reliance on countermeasures in the form of market access restrictions, which disfavour Members with a lower value of imports. In this regard, we note that there is no restriction on the *types* of countermeasures under Article 4.10 of the SCM Agreement. In

c. The countermeasures considered in light of the gravity of the breach

3.43 Brazil invokes the gravity of the breach in this case as an aggravating factor justifying the use of a methodology that produces a high level of countermeasures. Canada, on the contrary, claims that its breach is less serious than Brazil's violation in *Brazil – Aircraft*.

3.44 We recall that the Arbitrator in *US – FSC* considered that in assessing the "appropriateness" of countermeasures, a margin of appreciation is to be granted in light of the gravity of the breach at issue.<sup>83</sup> However, we believe that the Arbitrator in *US – FSC* used the term "the gravity of the breach" in the context of discussing the prohibited nature of export subsidies in general.<sup>84</sup> Comparatively, it appears to us that what the parties are referring to in this case under the term "gravity of the breach" concerns the *characteristics* of the specific prohibited subsidy at issue, i.e. whether it relates to one transaction or is a recurrent programme, whether it is based on "self defence" in response to other subsidies or whether it targets a particular market or competitor.

3.45 Our reading of the *US – FSC* report, however, does not mean that we are precluded from taking into account the characteristics of this particular subsidy pointed out by Brazil, since such characteristics may constitute relevant elements of original violating measures against which the proportionality of countermeasures should be measured. Our examination of such characteristics of this subsidy, in our view, does not justify a particularly high level of countermeasures. The gravity of granting a prohibited subsidy is assessed in absolute terms against the rule or principle that was breached. However, the gravity of a *particular* prohibited subsidy based on its characteristics may only be assessed in a relative manner, through a comparison with the characteristics of other subsidies. The only reliable comparator available in this field is Brazil's programme of subsidization for regional aircraft addressed in the *Brazil – Aircraft* proceedings. We first note that the measure at issue in *Brazil – Aircraft* was a programme of subsidization which was not limited in time, whereas the measure at issue in this case relates to a finite amount of subsidy. Second, the amount of subsidy expended by Brazil or for which commitments existed at the time the Article 22.6 arbitration took place in *Brazil – Aircraft* was much higher than in the present case. Third, even if we were to assess the gravity of the subsidy at issue on the basis of its "competitive harm", we have no reason to believe that any of the factors to be considered in assessing such harm would be significantly different in the two cases, with the consequence that there is no reason to assume that the harm caused by Canada's subsidy should be proportionally higher than the harm caused by Brazil's subsidy, as reviewed by the *Brazil – Aircraft* Arbitrator. The fact that Canada targeted Embraer offers is also of limited significance. Since Brazil and Canada are the main competitors in the regional aircraft sector, any offer from one *ipso facto* targets the other.

3.46 In conclusion, even if the characteristics of a particular subsidy might sometimes justify the application of a particularly high level of countermeasures, we see no reason to consider that the characteristics of Canada's subsidy in this case do so. Thus, this factor is not helpful in assessing the appropriateness of the proposed level of Brazilian countermeasures in this case.

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this particular case, however, what Brazil requested for as countermeasures is suspension of tariff concessions and other WTO obligations which are related only to market access restrictions. Finally, we wish to stress that, although the value of bilateral trade is one of the important factors for the Arbitrator's determination under 4.10 of the SCM Agreement under certain circumstances in a particular case such as ours, it may not be deemed to be a universally applicable decisive factor of which consideration alone, under any circumstances, always compels the Arbitrator to conclude that the proposed countermeasures are not appropriate.

<sup>83</sup> See *US – FSC (Article 22.6 – US)*, para. 5.62.

<sup>84</sup> *Ibid.*, paras. 6.7-6.9. The *FSC* Arbitrator noted the systemic and widely available nature of the FSC/ETI scheme, but in the context of confirming how the balance of rights and obligations had been upset in that particular case involving a prohibited export subsidy programme and for the purpose of establishing the right of the EC to counter the subsidy by a measure equivalent in amount.

d. The countermeasures considered in light of the need to induce compliance

3.47 One of the recognized purposes of countermeasures is to induce the defaulting party to comply with DSB recommendations. In this case, Brazil argues that the application of its methodology is necessary in order to set a level of countermeasures that will be sufficiently high to induce compliance. We note that inducing compliance was a concern expressly mentioned by the Arbitrators in *Brazil – Aircraft*<sup>85</sup> and in *US – FSC*.<sup>86</sup> For example, the report in *US – FSC* stated:

"5.57 In our view (...) when assessing the scope of what may be deemed "appropriate" countermeasures, we should keep in mind the fact that the subsidy at issue has to be withdrawn and that a countermeasure should contribute to the ultimate objective of withdrawal of the prohibited subsidy without delay."

3.48 We agree that the need to induce compliance is a factor that should be considered in evaluating the appropriateness of the level of proposed countermeasures. In terms of this case and in light of our analysis thus far, the issue is whether the need to induce compliance by Canada should cause us to find that the level of countermeasures proposed by Brazil is appropriate, notwithstanding our finding above that the proposed level of countermeasures is not appropriate in terms of Article 4.10 of the SCM Agreement. We are not convinced that we should change our finding because of the uncertainty as to the level of countermeasures that would result in compliance. That uncertainty exists because, in addition to the level of the countermeasures, the nature of the countermeasures and the sectors subject to countermeasures have a role in determining likely compliance. In addition, other factors internal to the Member subject to the countermeasures may have an impact. While the logic underpinning countermeasures is that higher countermeasures are more likely to induce compliance than lower countermeasures, the requirement that countermeasures be "appropriate" precludes reliance on that logic alone. Thus, we conclude that the need to induce compliance does not justify changing our finding that the level of countermeasures proposed by Brazil is not appropriate in light of our finding in paragraph 3.23 and the other relevant factors examined above.<sup>87</sup>

e. Are the proposed countermeasures manifestly excessive?

3.49 Brazil argues, relying on the *US – FSC* report<sup>88</sup>, that any level of countermeasures that is not "manifestly excessive" should be considered appropriate. We understand this to be more of a general argument about what appropriateness or disproportionality means in Article 4.10 of the SCM Agreement. First, we doubt that the Arbitrator in *US – FSC* considered that the term "disproportionate" in footnote 9 to Article 4.10 was meant to equate to "manifestly excessive", as claimed by Brazil. We consider that the language on which Brazil relies should be read in the broader context of the discussion of the *US – FSC* Arbitrator regarding the relationship between the words "appropriate" and "disproportionate", which we have set out in Section III.C above. As noted by the Arbitrator in *US – FSC*,

"(...) there is a requirement to avoid a response that is disproportionate to the initial offence – to maintain a *congruent relationship in countering the measure at issue so that the reaction is not excessive in light of the situation to which there is a response.*

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<sup>85</sup> Decision by the Arbitrator, *Brazil – Aircraft (Article 22.6 – Brazil)*, paras. 3.44, 3.54, 3.57 and 3.58.

<sup>86</sup> Decision by the Arbitrator, *US – FSC (Article 22.6 – US)*, paras. 5.51-5.60. We recall that both in *Brazil – Aircraft* and in *US – FSC* the Arbitrators chose to use the full amount of the subsidy, without any adjustment.

<sup>87</sup> In our view, this conclusion does not preclude a consideration of adjusting the level of countermeasures produced by a different methodology in different circumstances.

<sup>88</sup> Decision by the Arbitrator, *US – FSC, (Article 22.6 – US)*, para. 5.24, footnote 51.



But this does not require exact equivalence – the relationship to be respected is precisely that of "proportion" rather than "equivalence."<sup>89</sup>

In other words, some congruence must remain between the countermeasure and the measure to which it responds. Therefore, we consider that we need not examine whether the level of Brazil's proposed countermeasures is "manifestly excessive" or not.

#### 4. Conclusion

3.50 Accordingly, in light of our discussion in the foregoing paragraphs, we find that Canada has established that the countermeasures proposed by Brazil are not appropriate in terms of Article 4 of the SCM Agreement. First, the methodology proposed by Brazil is based on assumptions that are not sustainable. Second, the result of the methodology is a level of countermeasures that is not appropriate.

3.51 As noted at the outset, however, Canada admits that in light of its non-compliance with DSB recommendations Brazil is entitled to impose countermeasures. Canada argues that an appropriate starting point for calculating the level of such countermeasures is the amount of the subsidy that will be granted on aircraft not yet delivered as of 20 May 2002, when Canada should have withdrawn the subsidy. Given Canada's concession and the fact that the two prior arbitrations under Article 4.10 of the SCM Agreement have used the amount of the subsidy as the basis for approving proposed countermeasures, we find it proper as a starting-point to calculate the level of countermeasures in this case based on the amount of the subsidy methodology, subject to adjustments if necessary to ensure that the level of countermeasures is appropriate. In this regard, we note that prior Arbitrators that have rejected proposed levels of countermeasures (or suspensions of concessions) have always proceeded to set levels consistent with the relevant agreements.<sup>90</sup>

#### E. CALCULATION OF THE AMOUNT OF "APPROPRIATE COUNTERMEASURES"

##### 1. Determination of the amount of the subsidy

3.52 For the reasons mentioned above, we find it proper as a starting-point to use a methodology based on the amount of the subsidy for the calculation of the "appropriate countermeasures" in this case. We recall that Canada, in its first written submission, suggested that the subsidy be calculated "as the discounted present value of the difference in payment streams under the subsidized financing compared to an estimated market financing, where the present value is calculated as of the date of delivery of the individual aircraft."<sup>91</sup>

3.53 Brazil contests the calculation methodology proposed by Canada, claiming that the amount of subsidy actually corresponds to the entire value of the loan – the financing provided by EDC Canada Account – not merely a portion of it.<sup>92</sup> Contrary to the situation in *Brazil – Aircraft*, where the "financial contribution", within the meaning of Article 1.1(a)(1) of the SCM Agreement, was the direct PROEX interest-equalization payment, not the loan, Brazil believes that the financial

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<sup>89</sup> Decision by the Arbitrator, *US – FSC*, (Article 22.6 – *US*), para. 5.18, emphasis added.

<sup>90</sup> Except in *United States – FSC*, Arbitrators have always rejected the level proposed by the Member requesting the right to suspend concessions or other obligations and set a new level, based on their own assessment (see *EC – Bananas III (United States)* (Article 22.6 – *EC*): US\$520 million requested, US\$191.4 million authorized; *EC – Hormones (United States)* (Article 22.6 – *EC*): US\$202 million requested, US\$116.8 million authorized; *EC – Hormones (Canada)* (Article 22.6 – *EC*): Can\$75 million requested, Can\$11.3 million authorized; *EC – Bananas III (Ecuador)* (Article 22.6 – *EC*) US\$450 million requested, US\$201.6 million authorized; *Brazil – Aircraft*: Can\$ 700 million requested, Can\$344.2 million authorized).

<sup>91</sup> Canada first submission, para. 19.

<sup>92</sup> Brazil rebuttal submission, paras. 41-51; Brazil's replies to the questions of the Arbitrator, para. 67. Brazil's comments on Canada's replies to the questions of the Arbitrator, paras. 26-29

contribution in this case is the loan itself given by the Government of Canada.<sup>93</sup> Moreover, Brazil contends that, contrary to what is claimed by Canada, the amount of the subsidy should not be based on the benefit to the recipient, but rather on the definition of what constitutes a subsidy, contained in Article 1 of the SCM Agreement.

3.54 We note that the Panel in this case found that: "the EDC Canada Account financing to Air Wisconsin constitutes a prohibited export subsidy contrary to Article 3.1(a) of the SCM Agreement".<sup>94</sup> We note, however, that the findings requested from a panel are different from those requested from an Arbitrator under Article 22.7 of the DSU and Article 4.11 of the SCM Agreement. A panel is requested to establish the existence of a violation leading to a presumption of nullification or impairment. An Arbitrator is essentially requested to determine whether the proposed level of countermeasures is appropriate.

3.55 In any event, we recall that the Panel in this case determined the existence of a subsidy on the basis of the definition in Article 1 of the SCM Agreement. That Article provides that "a subsidy shall be deemed to exist" where, *inter alia*, there is a financial contribution by a government *and* a benefit is thereby conferred. These requirements are cumulative, i.e., they must both be satisfied in order for a subsidy to exist. In the present case, the Panel identified a financial contribution in the form of a direct transfer of funds.<sup>95</sup> The Panel further concluded that a benefit was conferred, and a subsidy therefore existed, because that financial contribution (in this case, a loan) was not provided on market terms.

3.56 Our task in this arbitration is not of course to re-consider the determination of the Panel regarding the *existence* of a subsidy, but to consider the *amount* of the subsidy in our determination of whether the level of countermeasures proposed is appropriate. The Appellate Body, in *Canada – Aircraft*<sup>96</sup>, has made clear that the *existence* of a benefit, within the meaning of Article 1.1(b)

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

However, Article 1 does not give us any specific guidelines as to how we should *calculate* the *amount* of the subsidy in the case of a loan.

3.57 In its submissions, Canada refers to Article 14 of the SCM Agreement, which provides guidelines for the calculation of the amount of a subsidy for the purpose of imposing countervailing duties, to support its view that, in the case of a loan, the amount of subsidy on which countermeasures should be based should correspond to the difference between the interest rate applied to the financing and the commercial interest rate which Air Wisconsin could have secured for the transactions at issue.

3.58 We recall that Article 14(b) of the SCM Agreement provides that:

"For the purpose of Part V, any method used by the investigating authority to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1

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<sup>93</sup> Brazil rebuttal submission, para. 43.

<sup>94</sup> Panel Report, para.8.1(e)

<sup>95</sup> Panel Report, para. 7.142.

<sup>96</sup> See Appellate Body Report in *Canada – Aircraft*, para. 157.

shall be provided for in the national legislation or implementing regulations of the Member concerned and its application to each particular case shall be transparent and adequately explained. Furthermore, any such method shall be consistent with the following guidelines:

(...)

(b) a loan by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the loan pays on the government loan and the amount the firm would pay on a comparable commercial loan which the firm could actually obtain on the market. In this case the benefit shall be the difference between these two amounts;"

3.59 We note that the field of application of Article 14 seems to be limited to the application of countervailing measures. However, we also note that the introductory paragraph of Article 14 refers to methods "to calculate the benefit to the recipient conferred pursuant to paragraph 1 of Article 1". We therefore conclude that while Article 14(b) relates specifically to proceedings under Part V of the SCM Agreement, the guidelines contained therein are relevant context in considering how to calculate the amount of the subsidy in the case where countermeasures have to be assessed under Article 4.11 of the SCM Agreement, as recalled by the Appellate Body in *Canada – Aircraft*.<sup>97</sup>

"(...) Article 14 sets forth guidelines for calculating the amount of a subsidy in terms of 'the benefit to the recipient'. Although the opening words of Article 14 state that the guidelines it establishes apply '[f]or the purposes of Part V' of the *SCM Agreement*, which relates to 'countervailing measures', our view is that Article 14, nonetheless, constitutes relevant context for the interpretation of 'benefit' in Article 1.1(b). The guidelines set forth in Article 14 apply to the calculation of the 'benefit to the recipient conferred pursuant to paragraph 1 of Article 1'. (emphasis added) This explicit textual reference to Article 1.1 in Article 14 indicates to us that "benefit" is used in the same sense in Article 14 as it is in Article 1.1. Therefore, the reference to 'benefit to the recipient' in Article 14 also implies that the word 'benefit', as used in Article 1.1, is concerned with the 'benefit to the recipient' and not with the 'cost to government', as Canada contends."

3.60 In the light of the above, we conclude that, in this case, it is appropriate to calculate the amount of the subsidy on the basis of the benefit conferred by the loan. We also agree with Canada that, in such a case, the amount of the subsidy should correspond to the difference between the amount Air Wisconsin pays on the loan from EDC and the amount Air Wisconsin would pay on a comparable commercial loan which that company could actually obtain on the market.

3.61 This conclusion is not inconsistent with the approach to calculating the amount of subsidy taken in *Brazil - Aircraft*. In that case, the Arbitrators used as the basis for its calculation of the amount of the subsidy the net amount of the grant received by the airlines purchasing the subsidized aircraft, having previously deducted the commission of the intervening bank. In the case of a grant, the net financial contribution received, and the amount of the benefit conferred within the meaning of Article 1, are the same. That is not of course true in the case of a loan, where the subsidy component may be far less than the face value of the loan.

3.62 Brazil argues that, in a sector where foreign trade is highly competitive, "just a few basis points" below the market could be enough to win a contract. In such a case, if one were to apply the methodology suggested by Canada, the "prohibited portion" of the export financing operation would

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<sup>97</sup> Appellate Body Report, *Canada – Aircraft*, para. 155.

be very small and the level of countermeasures would be very small too, compared with the value of the transaction or the total amount of the financing provided.

3.63 We agree with Brazil that, in a market as competitive as the market for regional jets, even a limited difference in interest rates, if it allows a manufacturer to win a contract, could have a disproportionate impact compared with the amount of subsidy granted, calculated on the basis of the benefit conferred. On the one hand, we do not consider that this is a sufficient reason for us to depart from what we understand to be the approach mandated by Article 1 and Article 14 of the SCM Agreement for a case involving, as this one does, a subsidized loan.<sup>98</sup> On the other hand, we recall that the terms "appropriate" in Article 4.10 of the SCM Agreement allows us some flexibility in order to address situations of this type and to that end we consider below the appropriateness of various adjustments to the level of countermeasures that we calculate on the basis of the amount-of-the-subsidy methodology.

3.64 For these reasons, we decide to calculate the amount of the subsidy as the discounted present value of the difference in payment streams under the subsidized financing compared to an estimated market financing.

## 2. Calculation of the amount of subsidy per aircraft

### (a) Introductory remarks

3.65 In this section, we address the calculation of the amount of subsidy per aircraft. However, this amount is only the basis on which the countermeasures should be determined. Adjustments to take into account the specific circumstances of this case are addressed in the following section.

### (b) Model of aircraft and number of subsidized aircraft not delivered as of 20 May 2002

#### (i) *Model of Aircraft*

3.66 The press release issued by Bombardier on 16 April 2001 after the signature of the Air Wisconsin contract<sup>99</sup> refers to the sale of CRJ-200 aircraft. We were not informed of any modifications at the delivery stage in this respect. We will therefore assume that the Air Wisconsin contract related to the sale of only one model of aircraft.

#### (ii) *Number of subsidized aircraft not delivered as of 20 May 2002*

3.67 Canada argues that, under the methodology based on the amount of the subsidy, the value of the subsidy per aircraft has to be multiplied by the number of aircraft that have been, or will be, delivered after the compliance date. Canada claims that all transactions with Air Nostrum and Comair had been completed by 20 May 2002. As far as Air Wisconsin is concerned, Canada relies on the Bombardier press release of 16 April 2001 to state that the sales consisted of 51 firm orders and 24 conditional orders, plus 75 options for which Canada claims that no financing would be extended if they were exercised.<sup>100</sup> Out of the 51 firm orders, 12 were delivered before the compliance date, leaving 39 firm orders still to be delivered.<sup>101</sup> As far as conditional orders are concerned, Canada claims that, under the current circumstances, approximately 20 out of 24 of those conditional orders would become firm. Regarding options, Canada claims that, even if they are exercised, no subsidy will be granted in relation to those transactions.

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<sup>98</sup> We are aware of the content of Annex IV of the SCM Agreement on the calculation of the total *ad valorem* subsidization under Article 6.1(a). However, Article 6.1(a) is no longer applicable.

<sup>99</sup> Exhibit CDA-3.

<sup>100</sup> Canada first submission, para. 27.

<sup>101</sup> *Ibid.*



3.72 The evidence provided by the parties does not allow us to determine definitively whether all conditional orders will be confirmed. The information submitted by the parties tend to show that there will be a growth in the regional jet market, but it is not clear by how many aircraft. We note in this respect that the number of conditional orders is relatively small (24) compared with the number of options (75). Obviously, Air Wisconsin will confirm its conditional orders – which are, as mentioned above, subsidized, before it exercises its options.

3.73 In any event, conditional orders are part of the financing package found by the Panel to be a prohibited subsidy. Therefore, we consider that we should include all the conditional orders in the total amount of subsidized aircraft unless we are given convincing reasons that those orders will not all be confirmed. As mentioned above, there is no clear evidence regarding the likelihood of the confirmation or not of all conditional orders, although xxx xxxxxx xxxxxxxxxxx xx xxx xxxxxxxxxxx xxxxxxxxxxx would seem to make confirmation of the conditional orders more likely than before. We therefore conclude that we should include them in the total number of subsidized aircraft for the purpose of our calculation.

(c) Price of the aircraft

3.74 Canada claims that the aircraft price calculated by Brazil on the basis of the Bombardier press release of 16 April 2001 is based on the CRJ-200 list price, and that this amount should be discounted by xx per cent to reach the actual price at which the aircraft were sold to Air Wisconsin. In support of its position, Canada supplied: (a) a letter from Bombardier confirming that the disclosed value of the transaction is based on the list price<sup>108</sup>; and (b) a letter from the analyst firm BK Associates, Inc.,<sup>109</sup> stating, *inter alia*, that "it [was] entirely reasonable, and even, likely, that Air Wisconsin would negotiate and obtain a discount of xx per cent off the list price for an order of 75 aircraft".<sup>110</sup> At our request, Canada also submitted credentials for this firm.<sup>111</sup>

3.75 Brazil contends that the amount referred to in the Bombardier press release of 16 April 2001 is the actual amount of the transaction, and that any discount is: (a) less than xx per cent; and (b) included in the amount made public. Brazil also argues that the letters produced by Canada, since they were prepared after the initiation of these proceedings and for the purpose of this case, should not be given the same probative value as a press release produced before the case was initiated.

3.76 We note that both parties start, for the determination of the price of the subsidized aircraft, with the figures given by Bombardier in its press release of 16 April 2001. The main issue is consequently whether any discount should be applied to this amount. As far as the information given by BK Associates is concerned, we have no reason to doubt the independence of this firm. However, this letter is only a reasonable assessment of what the practice of the industry would be in similar circumstances. It is not a description of what Bombardier actually did in the Air Wisconsin contract. We note that the letter of xxx xx xx xxxxxxx from Bombardier merely states that the "contract value" may not correspond to the actual price of the aircraft. However, it does not specify by how much this value should be adjusted to correspond to the actual unit price. As a result, while it confirms that the contract value may not correspond to the actual price paid for the aircraft, it is of limited use to determine by how much the contract value should be adjusted. We agree that Bombardier most

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"attractive financing conditions were attached to the conditional orders, which made it all the more certain that Air Wisconsin would convert all of the 18 remaining orders. xxx xxxxxxxxxxx xx xxx xxxxxxxxxxx xxxxxxxxxxx xxxxxxx x xxxxxxxxxxx xxxxxxxxxxx xxx xxxxxxxxxxx xxxx xxx xxxxxxxxxxx xxxxxx xx xxxxxxx xxx xxx xxxxxxx"

<sup>108</sup> Letter of xxxxxx xx xxxxxxx, Executive Vice-President, Bombardier, to Matthew Kronby, Deputy Director, Trade Law Bureau, Ministry of Foreign Affairs and International Trade of Canada, dated 31 October 2002 (Exhibit CDA-17).

<sup>109</sup> Hereafter "BK Associates".

<sup>110</sup> Letter of xxxx xx xxxxx of 19 September 2002 (Exhibit CDA-4).

<sup>111</sup> Exhibits CDA-18, 19, 20.

probably did not disclose the actual price of the aircraft in its press release of 16 April 2001. However, we have no precise basis on which to adjust the price mentioned in the press release. Canada and Bombardier know by how much the list price of the CRJ-200 was discounted in this contract. However, even though they request the Arbitrator to adjust the price of the aircraft concerned, they are unwilling to provide us with the actual information.<sup>112</sup> Under those circumstances, and bearing in mind that it is Canada, the party with the actual information, that is requesting an adjustment of the aircraft price, we decide not to make any such adjustment to the price calculated on the basis of the press release of 16 April 2001.

(d) Applicable market financing rate

3.77 The parties did not discuss Canada's suggested use of the xxxx<sup>113</sup> xxxxxxxxxxxx xx xxx xxxx xx xxx xxxxxx xx xxxxx xx xxx xxx xxxxxxxxxxxx xxxxxxxxxxx xxxxxxxxxxxxxxxxxxxx xx xxx xxxxxxxxxxx xxxxxx. They focussed their arguments on the estimated market financing rate to be applied in the comparison. In its calculation, Canada uses an estimated market financing rate on the date of the letter of offer, or xxxx per cent, based on what Canada considers a comparable discount rate used to value the stream of payments.<sup>114</sup> In the absence of externally rated actively traded Air Wisconsin's debt, Canada used a market benchmark that corresponded as closely as possible to the credit risk of Air Wisconsin as of the date of the letter of offer.<sup>115</sup> That market benchmark was a May 2001 pricing for the xxxx xx xxxxxxxx EETC.

3.78 Brazil argues that the use by Canada of the May 2001 pricing for the xxxx xx xxxxxxxx EETCs is a questionable choice. The carrier and the equipment types are quite different. Even if one were to accept Canada's use of EETCs spreads, which Brazil considers questionable, the May 2001 spreads on CRJ EETC debt should be used instead.<sup>116</sup>

3.79 With regard to the specific question of the applicable financing rate, we tend to agree with Brazil that some of the elements in the xx xxxxxxxx rate used by Canada may not seem to be comparable with the situation of Air Wisconsin. However, we note that Canada provided a detailed explanation of its calculation of the "proxy" commercial rate, acknowledging the difficulties encountered. We believe that, by doing so, Canada made a prima facie case that the rate of xxxx per cent that it identified was a reasonable proxy. While we acknowledge that Brazil argues in general that basing countermeasures on the amount of subsidy is inappropriate in this case, we recall that we expressly requested Brazil to comment on the estimated market rate calculated by Canada, as well as on any other elements of Canada's proposed calculation, in our questions to the parties. Brazil raised some questions concerning the parameters applied by Canada but did not convincingly challenge Canada's calculations. Further, Brazil did not provide any alternative calculation.

3.80 We therefore believe that Canada made a prima facie case that the interest rate it has calculated could be a reasonable "proxy" commercial rate. We gave ample opportunity to Brazil to rebut Canada's arguments and evidence. Brazil chose to follow an approach which did not include a detailed rebuttal of Canada's calculation. In particular, we are of the view that Brazil did not submit either any sufficient argument or any evidence to support the use of another rate, whereas Canada replied to Brazil's arguments regarding the use of a commercial rate based on CRJ EETC debt in a manner which we consider sufficiently credible. As a result, we consider that, in the absence of

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<sup>112</sup> During our hearing, Canada offered to disclose the actual price of the aircraft in the Air Wisconsin transaction, but only to the Arbitrator. Brazil strongly objected. We rejected Canada's offer as incompatible with the principle of due process which should govern our proceedings.

<sup>113</sup> xxxxxxxxxxx xxxxxxxx xxxxxxxxxxx xxxxxx

<sup>114</sup> Canada first written submission, para. 25 and footnote 21.

<sup>115</sup> Canada comments on question No. 4 to Brazil, paras. 1-4.

<sup>116</sup> Brazil reply of 1 November 2002 to question No. 4 of the Arbitrator to Brazil, para. 64.

convincing elements that would justify the use of another rate, we should apply the proxy commercial rate of xxxx per cent suggested by Canada.

(e) Amount financed and duration of the financing

3.81 Canada, in its calculation, states that the Canada Account financing offer of 10 May 2001 to Air Wisconsin applied to a loan-to-value ratio of xx per cent of the value of the aircraft over a period of xxxx years.<sup>117</sup>

3.82 Brazil argues that most lenders in the market provide financing only according to 80 per cent and 15-year terms. Brazil considers that Canada's use of a xx per cent/xxxx-year term is inappropriate.<sup>118</sup>

3.83 We note that the xx per cent/xxxx-year conditions are referred in paragraphs 7.137 and 7.155 of the Panel Report. We agree with Brazil that these conditions might not be the most usual, but we see no particular reason to reject them and use the 80 per cent/15-year term suggested by Brazil instead. We recall that, in *Brazil – Aircraft*, the equalization payment was applied over a period of 15 years, as suggested by Brazil, but to 85 per cent of the value of the aircraft. We also note that other rates were identified in the Panel Report.<sup>119</sup>

3.84 We therefore decide to apply the financing to xx per cent of the value of the aircraft over a period of xxxx years.

(f) Methodology applied by the Arbitrator

3.85 On the basis of the above, we have decided to calculate the appropriate level of countermeasures on the following basis:

- (a) We start with the identification of the average sale price of the model of aircraft for which sales to Air Wisconsin are still subsidized after 20 May 2002, using the figure contained in Bombardier's press release of 16 April 2001.
- (b) The next stage consists of the calculation of the net present value of the subsidy per aircraft model using the sale price for the model concerned (CRJ-200), an EDC financing rate of xxxx per cent<sup>120</sup> for a financing corresponding to xx per cent of the price over a period of xxxx years, and an estimated commercial financing rate of xxxx per cent. Financing is calculated for the two rates applied over the same period. The difference in amount between the two is the net present value of the subsidy for each aircraft at the date of the financing of the transaction.
- (c) Finally, we multiply the total number of aircraft still to be delivered to Air Wisconsin after 20 May 2002 (including all conditional orders but not options) by the net present value of the subsidy per model.

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<sup>117</sup> Canada first submission, para. 20.

<sup>118</sup> Brazil reply to question No. 4 of the Arbitrator, para. 64.

<sup>119</sup> Panel Report, para. 7.235.

<sup>120</sup> As recalled in para. 3.77 above, Canada suggested that we use the xxxx applicable on 10 May 2001, which is the date of the letter of offer for the Air Wisconsin contract (Exhibit CDA-5). Canada mentioned that the actual interest rate charged would be fixed at xxxx on the date of delivery of the individual aircraft. Since not all aircraft had been delivered as of the time of this arbitration, we decided to apply xxx xxxx xxxx on the date of the letter of offer. This is consistent with the use of an estimated market financing rate determined on the date of the letter of offer.



(g) Calculation

(i) *Net present value of the subsidy per aircraft*

3.86 The table in Annex 1 to this report contains the calculation of the amount of subsidy per aircraft.

3.87 As mentioned above, we used as price of the aircraft the amount resulting from the press release issued by Bombardier on 16 April 2001. The press release estimates the value of the 75 firm and conditional orders at approximately US\$1.68 billion, or US\$22.4 million per aircraft. For the reasons mentioned above, we did not apply any discount to that amount. Under those circumstances, the total financing per aircraft represents US\$xxxxxxxxxxxx. The difference between the present value of the sum of the actual payments @ xxxx per cent (US\$xxxxxxxxxxxx) and the present value of the sum of payments discounted at the estimated market financing rate of xxxx per cent that we agreed to use (US\$xxxxxxxxxxxx) gives the net present value of the subsidy per aircraft, i.e.: US\$3,277,735.

(ii) *Allocation over the total number of subsidized sales delivered after 20 May 2002*

3.88 On the basis of the elements described above, we considered that 39 firm orders had not been delivered by 20 May 2002. The total of all conditional orders was 24. We therefore multiply the result in (i) above by 63 aircraft.

(iii) *Net present value of the total amount of the subsidy*

3.89 The net present value of the subsidy per aircraft (US\$3,277,735) multiplied by the number of undelivered firm order and conditional orders as of 20 May 2002 (63 aircraft CRJ-200) equals US\$206,497,305.

3.90 The net present value of the total amount of the subsidy is: US\$206,497,305

### **3. Adjustments to the amount of the subsidy to identify an appropriate level of countermeasure**

(a) Preliminary remarks

3.91 We recall that Brazil proposed a level of countermeasures based on the competitive harm caused by Canada's subsidy but failed to sufficiently support its claim. We accepted Canada's methodology based on the amount of the subsidy as a proper starting point. The fact that we found it more appropriate to base our determination of the level of the countermeasures at issue on the amount of the subsidy does not mean that we have to limit the level of countermeasures to that amount. Canada recognizes that we have discretion to adjust the amount produced by its methodology and has presented arguments in favour of a downward adjustment in the level of countermeasures. Likewise, Brazil implicitly accepts this discretion in arguing that the amount of the subsidy methodology results in a level of countermeasures that is too low.

3.92 Here we recall again our agreement with the Arbitrator's findings in *US – FSC* that "countermeasures should be adapted to the particular case at hand."<sup>121</sup> Accordingly, we are authorized to consider relevant factors constituting the totality of the circumstances at hand in order to determine whether a specific level of countermeasures is appropriate in this particular case. Therefore, we address hereafter the arguments of the parties which, in our opinion, relate to factors that may justify an adjustment of the level of countermeasures to take into account the specificities of this case. We will begin with Canada's argument that the "appropriate countermeasures" should be lower than the

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<sup>121</sup> Decision by the Arbitrator, *US – FSC*, (Article 22.6 – *US*), para. 5.12, see para. 3.37, above.

amount of the subsidy. Then, we will proceed to address the issues raised in Brazil's arguments. We consider those issues to be the following: (i) the consequences to be attached to Canada's refusal to withdraw the subsidy at issue in relation to the principle according to which countermeasures are supposed to contribute to induce compliance; (ii) the risk of other "hit and run" actions by Canada if the level of countermeasures does not constitute a sufficient deterrent; and (iii) the impact that even a small difference of interest rate can have on the market for regional aircraft.

- (b) Canada's argument that the "appropriate countermeasures" should be lower than the amount of the subsidy

3.93 Canada recalls that the *US – FSC* Arbitrator found that countermeasures should be adapted to the case at hand. The circumstances of this case make Canada's violation a less egregious breach than that of Brazil in *Brazil – Aircraft*. First, Canada was responding to a below-market offer of Embraer<sup>122</sup>; it acted not to upset the balance of rights and obligations, but to preserve them in the face of an imminent threat that Brazil itself would upset them. Second, Canada believes that it could still at the time consider in good faith that matching Embraer's offers through a subsidy was permitted under Item (k) of the Illustrative List in Annex I to the SCM Agreement. Canada acknowledges that the Article 21.5 DSU Panel in *Canada – Aircraft* noted its belief that "matching" was not an "interest rate provision".<sup>123</sup> However, Canada considers that the part of the panel reasoning dealing with this issue was *obiter dictum*, made in the absence of an actual disputed transaction.<sup>124</sup>

3.94 Brazil, relying on the reasoning of the Arbitrator in *United States - FSC*, insists on the gravity of the wrongful act, stating that it was premeditated and admittedly targeted at Embraer.<sup>125</sup> Brazil also contests Canada's claim that it could believe in good faith that its subsidy would be covered by Item (k) of the Illustrative List in Annex I to the SCM Agreement. Brazil considers that the Article 21.5 DSU panel on *Canada – Aircraft* had held that the "matching" provisions of the OECD Export Credit Arrangement did not bring an export credit practice into conformity with the interest rate provisions of the OECD Arrangement. Canada's "matching" could not be justified under Item (k).<sup>126</sup>

3.95 We recall again that the Arbitrator in *US – FSC* considered that "[the Member concerned] is entitled to act with countermeasures that properly take into account the gravity of the breach and the nature of the upset in the balance of rights and obligations in question."<sup>127</sup> A thorough reading of the *US – FSC* arbitration report, however, leads to our understanding that the gravity of the violation considered in *US – FSC* was pointed primarily to the fact that at issue was an export subsidy, which is *per se* prohibited.<sup>128</sup>

3.96 This does not mean that the characteristics of this particular subsidy, namely, an alleged action of "self defence" should not be examined at all by the Arbitrator in this case. Since Canada argues that such a characteristic of the subsidy in this case should be considered as a relevant factor justifying a downward adjustment of the level of countermeasures, we move to consider whether such argument is valid. In other words, does the fact that Canada replied through subsidisation to offset what it claims was an illegal Brazilian offer constitute an acceptable excuse which justifies a downward adjustment in the level of countermeasures calculated above, as requested by Canada?

3.97 The subsidy addressed in this arbitration, even if we were to admit that it was a response to a credible threat of subsidisation from Brazil, remains by nature an export subsidy, prohibited *per se*, as recalled by the Arbitrator in *United States - FSC*. The fact that Canada sought to "maintain [the]

<sup>122</sup> Canada first submission, paras. 15 to 18. Canada rebuttal submission, paras. 20-27.

<sup>123</sup> Panel Report in *Canada – Aircraft (Article 21.5 – Brazil)*, para. 5.126.

<sup>124</sup> Canada rebuttal submission, para. 23.

<sup>125</sup> See Brazil rebuttal submission, paras. 7 and 23-27.

<sup>126</sup> Brazil first submission, para. 10.

<sup>127</sup> Decision by the Arbitrator, *US – FSC, (Article 22.6 – US)*, paras. 5.41, 5.61, 5.62, 6.6, and 6.25.

<sup>128</sup> See, also, para. 3.44 above.

appropriate balance [of rights and obligations in question]"<sup>129</sup> by matching Brazil's offer goes against the very purpose of Articles 3 and 4 of the SCM Agreement, which is to ensure that export subsidies are not maintained.

3.98 In our opinion, accepting the Canadian suggestion to cut the level of countermeasures by half because it is a response to Brazil's subsidisation would also be contrary to Article 23 of the DSU. Canada should not take the law into its own hands. Nowhere does the SCM Agreement or the WTO Agreement condone in any way resorting to this type of countermeasure without prior recourse to the DSU, even if Brazil was at the origin of the subsidy competition.<sup>130</sup>

3.99 With reference to Canada's claim that it could believe in good faith that its attempt to "match" Brazil's offer would be permitted under the Item (k) "safe haven" of the Illustrative List of Export Subsidies, we first note that Canada was obviously aware of the reasoning contained in the Panel Report in *Canada – Aircraft (Article 21.5 – Brazil)* which, even if Canada is correct that it was only *dicta*, rejected that view.<sup>131</sup> That report, dated 9 May 2000, was adopted by the DSB on 4 August 2000. The Item (k) issue was not appealed by Canada. In that context, it may be debatable whether Canada could believe in good faith, when the Air Wisconsin subsidy was granted in 2001, that the subsidy could be justified under Item (k). Moreover, even assuming Canada had such a good faith belief in 2001, we are still of the view that this cannot be a justification for a downward adjustment. In WTO dispute settlement cases, it is probably true that most defending parties argue in good faith that they believed the measures at issue were in conformity with the relevant provisions of the WTO Agreement. Once such measures are found to be in breach of WTO obligations, those parties should not be entitled to special treatment in terms of remedies against such a breach because the violation was made in good faith. Should the Arbitrator consider this alleged good faith of the defending party for the purpose of a downward adjustment, almost all of the cases under Article 4.10 of the SCM Agreement might need such an adjustment, which would surely not be acceptable.

3.100 We therefore conclude that no adjustment of the amount of the subsidy is necessary in relation to this argument of Canada.

(c) Brazil's arguments that the "appropriate countermeasures" should be higher than the amount of the subsidy

3.101 Since Brazil did not accept the Canadian amount-of-the-subsidy methodology, it did not specifically argue that the result produced by the methodology should be adjusted upwards. However, in the context of justifying its own methodology and a high level of countermeasures, Brazil presented arguments that are relevant to the issue of whether the level of countermeasures produced by the Canadian methodology should be adjusted upwards. We have already dealt with Brazil's argument concerning the gravity of the Canadian violation. In this section we deal with: (i) Canada's refusal to withdraw the subsidy and "inducing compliance"; (ii) Brazil's alleged risk of other "hit and run" measures by Canada if the level of countermeasures is not sufficiently high to deter such measures in the future; and (iii) the potential disproportionate impact of even a small amount of the subsidy on a very competitive market.

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<sup>129</sup> Canada first submission, para. 6.

<sup>130</sup> In this case, the Canadian subsidisation is not presented as a reply to previous subsidization by Brazil, but as a concurrent action intended to prevent Brazil from gaining a contract thanks to its own financing programme.

<sup>131</sup> Panel Report in *Canada – Aircraft (Article 21.5 – Brazil)*, para. 5.126.

(i) *Canada's refusal to withdraw the subsidy and "inducing compliance"*

3.102 Brazil argues that countermeasures are designed to induce compliance. We have already expressed our agreement with that position.<sup>132</sup> Accordingly, we turn to the question of whether the "inducing compliance" function of countermeasures justifies an upward adjustment of the amount set in paragraph 3.90 above.<sup>133</sup>

3.103 First, we note that mere non-compliance with the recommendations and rulings of the DSB and the fact that Canada has not yet complied are not "aggravating factors" justifying a higher level of countermeasures. Under Article 22.1 of the DSU and Article 4.10 of the SCM Agreement, non-compliance is the very event justifying the adoption of countermeasures.

3.104 However, this does not mean that non-compliance may not become an aggravating factor in determining an appropriate level of countermeasures given the facts of a specific case. Indeed, we recall that, pursuant to the general principle of international law *pacta sunt servanda*, as embodied in Article 26 of the Vienna Convention on the Law of Treaties (1969), States are not only presumed to perform their treaty obligations in good faith, they are expected and obliged to do so. We also note that Article 27 of the same Vienna Convention specifies that obligations under internal law cannot excuse States from complying with their international obligations. We are mindful that the Vienna Convention is not intended to prevail over special provisions contained in other treaties applicable between the parties. However, we do not read anything in the DSU or in the SCM Agreement which would create a right not to comply with DSB recommendations and rulings.

3.105 On the contrary, while stating that neither compensation nor the suspension of concessions or other obligations is preferred to full implementation of a recommendation to bring a measure into conformity, Article 22.1 of the DSU is particularly clear as to the temporary nature of suspensions of concessions or other obligations, pending compliance. In this respect, the *EC – Bananas* Arbitrators, referring to this provision, expressed the view that suspension of concessions or other obligations was intended to induce compliance because it was temporary.<sup>134</sup> Moreover, we recall our agreement with the Arbitrator in *US – FSC* that the objective of the SCM Agreement in relation to Article 4.10 is to secure compliance with the DSB recommendation to withdraw the subsidy. In particular, Article 4.7 of the SCM Agreement requires the withdrawal of prohibited subsidies without delay.

3.106 In the present case, we asked Canada to clarify whether it actually did not intend to comply with the DSB recommendations. Canada confirmed that it would honour its contractual commitments to grant the financing found to be an illegal subsidy on the aircraft undelivered as of the compliance date.<sup>135</sup> We take this statement to mean that Canada does not now intend to withdraw the subsidy at issue, as is required pursuant to Article 4.7 of the SCM Agreement. In this connection, we note again paragraph 5.57 of the *US – FSC* report, which stated that:

"In our view (...) when assessing the scope of what may be deemed "appropriate" countermeasures, we should keep in mind the fact that the subsidy at issue has to be withdrawn and that a countermeasure should contribute to the ultimate objective of withdrawal of the prohibited subsidy without delay."

3.107 In other words, we consider that countermeasures are there to contribute to the end of a breach. We also believe that the "appropriate" level of countermeasures should reflect the specific

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<sup>132</sup> See para. 3.48, above.

<sup>133</sup> While we found that the goal of inducing compliance could not justify the US\$3.36 billion level of countermeasures proposed by Brazil in light of our finding that such a level was inappropriate for other reasons, that finding does not preclude a consideration of whether a much lower level of countermeasures ought to be adjusted upwards in order to promote compliance.

<sup>134</sup> Decision by the Arbitrators, *EC – Bananas III (US) (Article 22.6 – EC)*, para. 6.3.

<sup>135</sup> Canada reply to question No. 6 of the Arbitrator, para. 1.

purpose of countermeasures. Keeping this in mind, we are of the view that Canada's statement that, for the moment, it does not intend to withdraw the subsidy at issue suggests that in order to induce compliance in this case a higher level of countermeasures than that based on the Canadian methodology would be necessary and appropriate.<sup>136</sup>

(ii) *The risk of other "hit and run" measures (the deterrence argument)*

3.108 Brazil states that it wants the Arbitrator to award a "significant level of countermeasures" so as to deter Canada from applying its subsidy regime to future sales of regional jets.<sup>137</sup> As Brazil puts it, "the lower the anticipated level of countermeasures, the higher the chances of 'hit and run' actions."<sup>138</sup>

3.109 The measure with respect to which the countermeasures are supposed to induce compliance is clearly the measure found inconsistent by the Panel. As can be seen from Article 22.2 DSU and Article 4.10 of the SCM Agreement, it is the non-compliance with the recommendations and rulings of the DSB that triggers the right to adopt countermeasures and the recommendations and ruling relate exclusively to the measure found to be illegal.

3.110 In the present case, the measures found to be illegal were the granting of subsidies to a number of transactions. The Panel Report clearly ruled that the EDC Corporate Account and Canada Account programmes "as such" did not constitute prohibited export subsidies contrary to Article 3.1(a) of the SCM Agreement. The DSB recommendations and rulings clearly cannot be interpreted as extending the right to take countermeasures to the maintaining of those programmes "as such".

3.111 Likewise, the findings of the Panel do not extend beyond the particular instance where the application of those programmes was found to be illegal. It is likely that an identical application of those programmes would, in identical circumstances, lead to an identical ruling. However, as long as this is not a matter that was before the Panel and it did not lead to recommendations of the DSB, we are not, as Arbitrator under Article 22.6 of the DSU and Article 4.10 of the SCM Agreement, allowed to address it.

3.112 We do not see other legal reasons why deterrence of future application of EDC Canada account and Corporate Account to finance sales of Canadian regional jets should be part of the factors to be taken into account in determining the appropriate level of countermeasures for this particular case. We note that the Panel applied the "classical" distinction between mandatory and discretionary legislation<sup>139</sup> and found that those programmes did not mandate subsidization of exports.<sup>140</sup> At this point in time, from the point of view of WTO law and practice, the mere possibility of another breach

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<sup>136</sup> Canada argues that, in *Brazil – Aircraft (Article 22.6 – Brazil)* too, the Arbitrators noted the statement of Brazil that it did not intend to comply with the recommendations and rulings of the DSB with respect to the contracts that had been already concluded. Canada refers to para. 56 of Brazil's written submission in *Brazil – Aircraft (Article 22.6 – Brazil)*. However, the Arbitrators did not draw any particular conclusion from that statement. In the present case, however, we believe that there is no legal reason for us to be prevented from giving some weight to the position of Canada in terms of determining the appropriate level of countermeasures.

<sup>137</sup> We note that Brazil uses this systemic argument to justify a recourse to a methodology based on lost sales or harm to Embraer and Brazil. The fact that we rejected the application of Brazil's proposed methodology does not mean, however, that we should disregard its argument in determining an "appropriate" amount of countermeasure. We should therefore address the question whether deterrence of future similar violations should be one of the elements to take into account.

<sup>138</sup> Brazil closing statement at the hearing of the Arbitrator with the parties.

<sup>139</sup> Panel Report, paras. 7.56–7.68.

<sup>140</sup> *Ibid.*, paras. 7.84–7.85 (EDC, by virtue of being an ECA); paras. 7.96–7.97 (EDC Canada Account); paras. 7.112–7.113 (EDC Corporate Account); 7.126–7.127 (*Investissement Québec*).

resulting from the existence of the programmes contained in a discretionary legislation seems difficult to incorporate in our assessment of "appropriate countermeasures". Indeed, this would be equivalent to disregarding the legal consequences of the distinction between mandatory and discretionary laws.

3.113 We need not decide that, if there were a pattern over time of illegal subsidisation and non-compliance, such facts could not or should not be taken into account. In our view that situation is not the case before us, and therefore no adjustment is appropriate in this particular case.

(iii) *The potential disproportionate impact of the subsidy on the market*

3.114 As part of its arguments on the gravity of Canada's breach, Brazil addresses a specific issue. Brazil argues that, in a sector where international trade is highly competitive, "just a few basis points" in interest rate below the market rate could be enough to win a contract.

3.115 We agree in principle with Brazil that, in a market as competitive as the market for regional jets, even a limited difference in interest rates, if it allows a manufacturer to win a contract, may have a disproportionate impact, calculated on the basis of the trade impact, compared with the amount of subsidy granted.

3.116 We note that, in some such cases, countermeasures equal to the amount of the subsidy might be viewed as insufficient to induce compliance. Nonetheless, we have already concluded that an adjustment is appropriate in light of the need to induce compliance. Thus, in our view, Brazil's concern here has already been taken care of in assessing the appropriate level of countermeasures and, hence, justifies no further adjustments.

3.117 In any event, we note that the situation before us is different from that referred to by Brazil. The countermeasures in this case are not based on a subsidy equal to "a few basis points" of interest rate. In this case, the difference on which the countermeasures are based is that between the interest rate which we have accepted as the applicable rate for the Air Wisconsin contract (xxxx per cent), and the interest rate which we have accepted as representative of the market for this type of transaction (xxxx per cent), that is more than "a few basis points".

3.118 Under these specific circumstances, we conclude that no adjustment is necessary in this case in this respect.

(d) *Conclusion on adjustments*

3.119 In the light of the above, we consider it appropriate to adjust the result of our calculations based on the amount of subsidy to take into account the fact that Canada, until now, has stated that it does not intend to withdraw the subsidy at issue and the need to reach a level of countermeasures which can reasonably contribute to induce compliance.

3.120 We acknowledge that such adjustments cannot be precisely calibrated. Canada's request for a 50 per cent reduction of the level of countermeasures based on its claims that it was in good faith and that its breach was not grave is evidence of the difficulty to assess precisely the monetary value of such adjustments.

3.121 Recalling Canada's current position to maintain the subsidy at issue and having regard to the role of countermeasures in inducing compliance, we have decided to adjust the level of countermeasures calculated on the basis of the total amount of the subsidy by an amount which we deem reasonably meaningful to cause Canada to reconsider its current position to maintain the subsidy at issue in breach of its obligations. We consequently adjust the level of countermeasures by an amount corresponding to 20 per cent of the amount of the subsidy as calculated in Section III.E above, i.e.:

US\$206,497,305 x 20% (US\$41,299,461) = US\$247,796,766.

3.122 As we have noted in paragraph 3.120, adjustments such as the one we are making cannot be precisely calibrated. There is no scientifically based formula that we could use to calculate this adjustment. In that sense, the adjustment might be viewed as a symbolic one. Even so, we are convinced that it is a justified adjustment in light of the circumstances of this case and, in particular, the need to induce compliance with WTO obligations. Without such an adjustment, we would not be satisfied that an appropriate level of countermeasures had been established in this case.

#### IV. AWARD OF THE ARBITRATOR

4.1 For the reasons set out above, the Arbitrator determines that, in the matter *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, the suspension by Brazil:

- (a) of the application of the obligation under paragraph 6(a) of Article VI of GATT 1994 to determine that the effect of subsidization under EDC Canada Account and EDC Corporate Account programmes is to cause or threaten material injury to an established domestic industry, or is to retard materially the establishment of a domestic industry;
- (b) of the application of obligations under the Agreement on Import Licensing Procedures relative to licensing requirements on imports from Canada; and
- (c) of tariff concessions and related obligations under the GATT 1994 concerning a list of products to be drawn from the list attached to its request;

covering trade in a total amount of US\$247,797,000 would constitute appropriate countermeasures within the meaning of Article 4.10 of the SCM Agreement.

4.2 In this respect, the Arbitrator urges Brazil to make sure that, if it decides to proceed with the suspension of certain of its obligations *vis-à-vis* Canada referred to in document WT/DS222/7, this will be done in such a way that the maximum level of countermeasures referred to in the preceding paragraph will be respected.

4.3 Finally, the Arbitrator would like to emphasize that Article 22.8 of the DSU provides that:

"The suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommendations or rulings provides a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached. (...)"

4.4 The Arbitrator understands that the parties have been holding consultations. The Arbitrator is of the opinion that, given the particular circumstances of this case, a mutually satisfactory agreement between the parties addressing the issues dealt with in this case *in their broader context* would be the most appropriate solution.





## ANNEX 2

### **CANADA – EXPORT CREDIT AND LOAN GUARANTEES FOR REGIONAL AIRCRAFT (WT/DS222) Recourse by Canada to Article 22.6 of the DSU and Article 4.11 of the SCM Agreement**

#### **Working Procedures**

The Arbitrators will follow the normal working procedures of the DSU where relevant and as adapted to the circumstances of the present proceedings, in accordance with the timetable they have adopted. In this regard,--

- (a) the Arbitrators will meet in closed session;
- (b) the deliberations of the Arbitrators and the documents submitted to them shall be kept confidential. However, this is without prejudice to the parties' disclosure of statements of their own positions to the public, in accordance with Article 18.2 of the DSU;
- (c) at any substantive meeting with the parties, the Arbitrators will ask Canada to present orally its views first, followed by Brazil;
- (d) the parties shall submit all factual evidence to the Arbitrators no later than the first written submissions to the Arbitrators, except with respect to evidence necessary for purposes of rebuttals or answers to questions. Exceptions to this procedure will be granted upon a showing of good cause. In such cases, the other party shall be accorded a period of time for comment, as appropriate;
- (e) the parties shall provide an electronic copy (on a computer format compatible with the Secretariat's programmes) together with the printed version (7 copies) of their submissions, including the methodology paper and comments thereon, on the due date. All these copies must be filed with the Dispute Settlement Registrar, Mr. Ferdinand Ferranco (Office 3154. Electronic copies may be sent by e-mail to Mr. Ferranco at DSregistry@wto.org). Parties shall provide 7 copies and an electronic version of their oral statements during or immediately after any meeting;
- (f) except as otherwise indicated in the timetable, submissions should be provided at the latest by 5.00 p.m. on the due date so that there is a possibility to send them to the Arbitrators on that date. As is customary, *distribution of submissions shall be made to the other party by the party themselves*;
- (g) if necessary, and at any time during the proceedings, the Arbitrators will put questions to the parties to clarify any point that is unclear;
- (h) any material submitted shall be concise, as brief as possible and limited to questions of relevance in this particular procedure;
- (i) parties shall provide a list of the participants of their delegation prior to, or at the beginning of, any meeting with the Arbitrators.

- (j) to facilitate the maintenance of the record of the arbitration, and to maximize the clarity of submissions and other documents, in particular the references to exhibits submitted by parties, parties shall sequentially number their exhibits throughout the course of the arbitration.

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