# WORLD TRADE ORGANIZATION

RESTRICTED

**WT/DSB/M/149**
8 July 2003

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**Dispute Settlement Body**
**7 May 2003**

## MINUTES OF MEETING

Held in the Centre William Rappard
on 7 May 2003

*Chairman: Mr. Shotaro Oshima (Japan)*

Subjects discussed: Page



### 1. United States – Investigation of the International Trade Commission in softwood lumber from Canada

(a) Request for the establishment of the a panel by Canada (WT/DS277/2)

1. The Chairman recalled that the DSB had considered this matter at its meeting on 15 April 2003 and had agreed to revert to it. He drew attention to the communication from Canada contained in document WT/DS277/2.

2. The representative of Canada said that this was his country's second panel request in the case on "United States – Investigation of the International Trade Commission in Softwood Lumber from Canada". He recalled that the matter had first been considered by the DSB at its meeting on 15 April. Unfortunately, the United States had blocked Canada's panel request at that meeting. Canada did not wish to repeat the reasons why it was seeking the establishment of a panel, as these reasons were set out in full both in the panel request and in Canada's statement made at the 15 April meeting. His delegation wished to refer Members to those documents, and reiterated its request for a panel at the present meeting.

3. The representative of the United States said that his country regretted that Canada had chosen to proceed with its panel request. The United States believed that Canada's claims lacked merit. The conclusion of the US International Trade Commission (ITC) that a US industry was threatened with material injury by reason of imports from Canada of softwood lumber was based on a proper establishment of the facts and an objective and unbiased evaluation of those facts. It had been reached in a manner fully consistent with applicable WTO rules. The United States intended to vigorously defend the ITC's determination before the panel.

4. The DSB took note of the statements and agreed to establish a panel in accordance with the provisions of Article 6 of the DSU with standard terms of reference.

5. The representatives of the European Communities and Japan reserved their third-party rights to participate in the Panel's proceedings.

**2. United States – Tax treatment for "Foreign Sales Corporations"**

(a) Recourse by the European Communities to Article 4.10 of the SCM Agreement and Article 22.7 of the DSU (WT/DS108/26)

6. The Chairman recalled that at the DSB meeting on 28 November 2000, the EC had requested authorization from the DSB to take appropriate countermeasures and to suspend the application to the United States of concessions pursuant to Article 4.10 of the SCM Agreement and Article 22.2 of the DSU. Since the United States had objected to the appropriateness of the countermeasures and the level of suspension of concessions proposed by the EC, the matter had been referred to arbitration, in accordance with Article 22.6 of the DSU and Article 4.11 of the SCM Agreement. He drew attention to document WT/DS108/ARB which contained the Arbitrator's decision on this matter as well as to the communication from the EC contained in document WT/DS108/26.

7. The representative of the European Communities said that he wished to recall the most important aspects of this dispute before explaining why the EC had now decided to request the DSB to authorize the suspension of concessions on certain US products. As stated in the EC's request, it was already back in October 1999, when the Panel in this dispute had found that the US "Foreign Sales Corporations" scheme violated both the SCM Agreement and the Agreement on Agriculture. The Appellate Body had confirmed this on 24 February 2000. The DSB had then recommended that the United States bring its measures into conformity with the provisions of those agreements, and that it withdraw the export subsidies at the latest with effect from 1 October 2000. On 12 October 2000, at its special meeting, the DSB had agreed to the request by the United States to allow it an extra time-period for implementation, which was due to expire on 1 November 2000.

8. On 15 November 2000, the US President had signed into law the FSC Repeal and Extraterritorial Income Exclusion Act of 2000, (the ETI Act). Soon after, on 17 November 2000, in accordance with procedures agreed with the United States, the EC had presented the DSB with both a request for countermeasures and suspension of concessions under Articles 4.10 of the SCM Agreement and Article 22 of the DSU respectively as well as a request for consultations under Article 21.5 of the DSU. The request indicated that countermeasures would take the form of imposing an additional duty on the specified products of up to 100 per cent *ad valorem* above the bound customs duties. It had been further stated that the products concerned would be eventually drawn from within the list of chapters of the Combined Nomenclature attached to the 17 November 2000 request by the European Communities.

9. On 27 November 2000, the United States had objected to the level of countermeasures requested by the EC and the matter had been referred to arbitration pursuant to Article 22.6 of the DSU. On 20 December 2000, the panel under Article 21.5 of the DSU had been established and on 21 December 2000, in accordance with the agreed procedures, the parties had requested the Arbitrators to suspend its work until the compliance proceedings had been over. On 29 January 2002 the DSB had adopted the Panel and the Appellate Body Reports declaring that the ETI Act violated the SCM Agreement, the Agreement on Agriculture and Article III:4 of GATT 1994. Finally, on 29 January 2002 the arbitration procedure had been reactivated and the Arbitrator's report authorizing countermeasures at the level of US$4,043 million had been circulated on 30 August 2002. It was clear from the above that the EC's request did not come hastily. Already three and a half years had lapsed from the original condemnation of the FSC export subsidy while two and a half years had lapsed from the expiry of the reasonable period of time within which the United States should have

complied. Moreover, more than a year had lapsed since the replacement ETI Act had been condemned. Throughout this period the EC believed that it had exercised considerable restraint in exercising its WTO rights and had avoided rushing into action.

10. He noted that Article 22.7 of the DSU provided that "The DSB shall be informed promptly of the decision of the arbitrator and shall upon request, grant authorization to suspend concessions or other obligations where the request was consistent with the decision of the Arbitrator, unless the DSB decided by consensus to reject the request." Thus, the EC could have already made such a request in the year 2002, but had avoided to do so for mainly two reasons. First, in order to be transparent with regard to the precise list of products on which any future countermeasures could apply, the EC had gone through an internal consultation exercise to select these products. No products other than those on the attached list would be selected for the purposes of countermeasures. Second, the EC wanted to give the United States some more time to comply with the DSB's recommendations taking into account the political realities in the United States.

11. At the same time, however, the EC had to be prepared for the exercise of its WTO rights. Although the United States had sent some encouraging signs of its will to comply, it had failed, however, so far to implement the DSB's recommendations and rulings. In that framework, the EC had decided to request authorisation from the DSB to take appropriate countermeasures and to suspend concessions pursuant to Article 4.10 of the SCM Agreement and Article 22.7 of the DSU for an amount of US$4,043 million per year in conformity with the decision of the arbitrator. As explained in its request, the EC intend to take countermeasures in the form of the suspension of tariff concessions and related obligations under the GATT 1994 by imposing an additional duty of up to 100 per cent ad *valorem* above bound custom duties on the attached list of US products (drawn from the indicative list which had been circulated jointly with the 17 November 2000 request).

12. To conclude on more positive tone, he said that obtaining the authorization did not mean that the EC would immediately resort to countermeasures. Notwithstanding the expiry of the reasonable period of time, the EC was still willing to give the United States a short additional period of time to make the necessary legislative changes before taking any action. Thus, the EC's objective was and remained full compliance: i.e. the removal of the illegal export subsidy.

13. The representative of the United States said that before turning to the EC's request for authorization and the decision of the Arbitrator underlying it, the United States would like to make one thing clear, and that was that it remained the intention of the United States to comply with the DSB's recommendations and rulings in this case. Thus, while the United States appreciated the fact that the EC had the right to request authorization to impose countermeasures, it did not believe that it would be necessary to ever exercise that authorization. Turning to the decision of the Arbitrator in this case, the United States noted that this was the first time that the decision had been formally before the DSB. However, the decision in this case was similar to the arbitration decision in the Canada – Aircraft dispute that Members had discussed at the 18 March DSB meeting. He recalled that at that meeting Canada had objected to the decision of the Arbitrator in its case to increase by 20 per cent the amount of the countermeasures. As Canada had correctly noted, the Arbitrator in that case had offered no justification for the 20 per cent increase, and the United States agreed with Canada that the adjustment was "determined capriciously".

14. In the view of the United States, however, this capricious outcome was not a surprise, because the arbitrator in the Canada Aircraft case had chosen to follow the arbitration decision in the FSC case. Thus, to the extent that the Canada – Aircraft decision was devoid of standards, it was because it was modelled on the FSC decision, which was itself devoid of any standard. The FSC arbitration decision was a seriously flawed document. At the present meeting, the United States wished to focus on just a few aspects of that decision, and would leave to scholars a thorough deconstruction.

15. First, there was the undefined standard used by the Arbitrator. By way of background, the central issue in the FSC arbitration was whether the amount of countermeasures imposed in response to a prohibited subsidy had to bear a relationship to the trade effect of the subsidy on the complaining Member. This was critical, because a reasonable estimate of the effects of the FSC/ETI subsidies on EC trade interests was roughly US$1 billion. The key provision at issue was Article 4.10 of the SCM Agreement, which referred to the imposition of "appropriate countermeasures" in the event of non-compliance. With respect to the phrase "appropriate countermeasures", footnote 9 to Article 4.10 stated that "[t]his 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."

16. Thus, the crucial question for the arbitrator was the following: What was footnote 9 referring to when it used the phrase "disproportionate"? Or, put differently, "disproportionate" with respect to what? The United States would not repeat all of the arguments that it made to the Arbitrator, but simply would note here that it continued to believe that a thorough – and objective – analysis of Article 4.10 based on its text, context, object and purpose, and negotiating history left no doubt that the proportionality (or disproportionality) of countermeasures had to be assessed in terms of the trade effects of the prohibited subsidy on the complaining Member. Thus, while the relationship between countermeasures and trade effects under Article 4.10 was not one of "equivalency" – as was the case under Article 22.4 of the DSU – countermeasures had to bear a relationship to the trade effects: i.e. they could not be disproportionate to the trade effects. In particular, it was absolutely clear from the negotiating history that the drafters had intended that countermeasures taken against prohibited subsidies would be based on trade effects. The minutes of the Uruguay Round Negotiating Group on Subsidies revealed that this was the position of every delegation that had spoken on this issue. Not a single delegation had expressed the view that countermeasures should be based on anything other than trade effects. Notwithstanding this, the arbitrator concluded, at paragraph 5.61 of its decision, that "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 ... ." Translated, what the arbitrator essentially said was that because an export subsidy was a measure that was not permitted under the WTO, countermeasures could be disproportionate to the trade effects of that measure. However, the Arbitrator never explained why export subsidies should be treated in a manner so radically different from any other WTO-inconsistent measure. The arbitrator did suggest that the purpose of countermeasures was to induce compliance. However, as the arbitrator in the EC – Bananas case stated, this also was the purpose of a suspension of concessions under Article 22.4 of the DSU. Therefore, this purpose could not justify the radical approach taken by the FSC arbitrator. Moreover, if "inducing compliance" was the standard, that was no standard at all, as was found out in the Canada – Aircraft arbitration. It appeared that the amount of countermeasures that would induce compliance in any given case would depend entirely upon the whim of the Arbitrator.

17. In any event, as a result of its flawed reasoning, the FSC arbitrator awarded countermeasures of over US$4 billion. Given that a reasonable (and generous) estimate of the effects of the FSC/ETI subsidies on EC trade interests was in the range of US$1 billion, the arbitrator's award exceeded the trade effects by at least four times. Under the arbitrator's so-called "standard", however, the result could just as easily have been forty-four times or four hundred and forty-four times the trade effects. Or, as in the Canada – Aircraft case, the Arbitrator could have tacked on an arbitrary 20, 40 or 100 per cent.

18. In addition to the fact that the standard used was no standard at all, there was another aspect of the FSC arbitration decision that the United States wished to call to Members' attention because of its systemic implications for the entire dispute settlement system. This was the arbitrator's treatment – or, to be precise, lack of treatment – of the negotiating history. As indicated previously, an examination of the negotiating history of the SCM Agreement left no doubt that the drafters had intended that countermeasures taken against prohibited subsidies had to be proportionate (or not disproportionate) to the trade effects on the complaining Member. Although the United States had

presented detailed arguments to the Arbitrator regarding this negotiating history, there was absolutely no reference to this negotiating history – or the US arguments relating thereto – in the arbitration decision. The absence of any discussion of the negotiating history was surprising. Given the lack of clarity in Article 4.10, which relied entirely on terms like "appropriate" and "disproportionate", one would think that this would be the precise situation contemplated by Article 32(a) of the Vienna Convention on the Law of Treaties, which called for recourse to a treaty's preparatory work when the application of Article 31 "leaves the meaning ambiguous or obscure". At a minimum, one would think that the arbitrator would refer to the negotiating history in order to confirm the meaning derived by the Arbitrator from the text.

19. Although there were many, many aspects of this arbitration decision with which the United States took issue, it found the Arbitrator's disregard of the negotiating history and the US arguments relating thereto extremely troubling. The United States agreed with the general proposition that an arbitrator, a panel, or the Appellate Body should not have to address every single argument made by the parties that appeared before it. On the other hand, in any given dispute, there would be arguments presented that were of sufficient weight that they had to be addressed by the tribunal in question in order to render a decision that was based on – and that was perceived as being based on – the law. In the view of the United States, the arguments that it had presented in the FSC arbitration regarding the negotiating history fell into the latter category, and it was incumbent upon the Arbitrator to either agree with them or explain why the United States was wrong.

20. Finally, the United States briefly wished to address the Arbitrator's declaration in paragraph 6.10 that the US obligation in this dispute was an *erga omnes* obligation owing to each and every Member. First, the United States noted the dubious quality legal analysis which, without foundation in the DSU, incorrectly and inappropriately purported to import into WTO jurisprudence the concept of *erga omnes*. This concept was drawn from public international criminal law, and described an obligation which was owed to all states. The concept *erga omnes* was squarely at odds with the fundamentally bilateral nature of WTO and GATT dispute settlement and with the notion that WTO disputes concerned nullification and impairment of negotiated benefits to a particular Member. WTO adjudicators were tasked with resolving disputes between specific complaining and defending parties. Adjudicators may not, through improper importation of the concept *erga omnes*, enforce WTO obligations on behalf of non-parties to a dispute. Moreover, the Arbitrator made no attempt to explain how *erga omnes* or any other concept of public international law could have been relevant to its analysis. Article 1.1 of the DSU limited WTO adjudicators to applying the covered agreements, although Article 3.2 of the DSU provided that adjudicators might apply rules of interpretation of public international law. The concept of *erga omnes* was not a rule of interpretation of public international law, and it was not reflected in Articles 31 or 32 of the Vienna Convention on the Law of Treaties. Reliance on public international legal concepts outside of rules of interpretation was not permitted under either DSU provision, and the arbitrator had erred in importing this concept as a means to justify its award.

21. The United States found the performance of the Arbitrator extremely troubling. To be clear, what concerned the United States was not the US$4 billion in countermeasures that the Arbitrator had awarded. US$4 billion was a large figure, to be sure. However, as indicated at the outset, the United States intended to comply with its obligations, regardless of what the amount of countermeasures was. Rather, what concerned the United States was that in the case of a regime like the WTO dispute settlement system which ultimately depended upon voluntary compliance in order to function properly, it was essential that the legal analysis of adjudicators carefully adhered to the terms of the WTO Agreement, based on cautious, well-explained analyses that addressed major arguments of the parties. Unfortunately, the FSC arbitration did not display these qualities.

22. The DSB took note of the statements and, pursuant to the request by the European Communities under Article 4.10 of the SCM Agreement and Article 22.7 of the DSU, contained in document WT/DS108/26, agreed to grant authorization to take appropriate countermeasures and to

suspend the application to the United States of concessions consistent with the Arbitrator's decision contained in document WT/DS108/ARB.