WORLD TRADE ORGANIZATION

WT/DS46/AB/RW
21 July 2000

(00-2990)

Original: English

BRAZIL – EXPORT FINANCING PROGRAMME FOR AIRCRAFT

RECOURSE BY CANADA TO ARTICLE 21.5 OF THE DSU

AB-2000-3

Report of the Appellate Body

WORLD TRADE ORGANIZATION
APPELLATE BODY

Brazil – Export Financing Programme for Aircraft

Recourse by Canada to Article 21.5 of the DSU

Brazil, *Appellant*
Canada, *Appellee*

European Communities, *Third Participant*
United States, *Third Participant*

AB-2000-3

Present:

Bacchus, Presiding Member
Ehlermann, Member
Lacarte-Muró, Member

I. Introduction

1. Brazil appeals from certain issues of law and legal interpretation in the Panel Report, *Brazil – Export Financing Programme for Aircraft, Recourse by Canada to Article 21.5 of the DSU* (the "Article 21.5 Panel Report").[1] The Article 21.5 Panel was established pursuant to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU") to consider a complaint by Canada with respect to the existence or consistency with the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*") of measures taken by Brazil to comply with the recommendations and rulings of the Dispute Settlement Body (the "DSB") in *Brazil – Export Financing Programme for Aircraft* ("*Brazil – Aircraft*").[2]

2. The original panel found as follows: "… we find that payments on exports of regional aircraft under the PROEX interest rate equalization scheme are export subsidies inconsistent with Article 3 of the SCM Agreement."[3] The original panel then recommended "that Brazil withdraw the subsidies

[1]WT/DS46/RW, 9 May 2000.

[2]The recommendations and rulings of the DSB resulted from the adoption, by the DSB, of the Appellate Body Report in *Brazil – Aircraft* and the original panel report in that dispute, as modified by the Appellate Body Report (Appellate Body Report, *Brazil – Aircraft*, WT/DS46/AB/R, adopted 20 August 1999; original panel report, *Brazil – Aircraft*, WT/DS46/R, adopted 20 August 1999, as modified by the Appellate Body Report). The DSB recommended that Brazil "withdraw" its prohibited export subsidies within 90 days, that is, by 18 November 1999.

[3]Original panel report, *Brazil – Aircraft*, *supra*, footnote 2, para. 8.2.

identified above without delay"[4], which in this dispute was found to be within 90 days.[5] On appeal, the Appellate Body upheld this recommendation.[6]

3. Brazil took steps to implement the recommendations and rulings of the DSB. Taking the view that the measures adopted by Brazil to comply with the recommendations and rulings of the DSB were not consistent with Article 3.1(a) of the *SCM Agreement*, Canada requested that the matter be referred to the original panel, pursuant to Article 21.5 of the DSU.[7] On 9 December 1999, the DSB referred the matter to the original panel.

4. The Article 21.5 Panel considered claims by Canada that Brazil had failed to comply with the recommendations and rulings of the DSB. Canada argued that Brazil continued to issue NTN-I bonds pursuant to letters of commitment issued before 18 November 1999 under the terms and conditions of PROEX before its modification; and that the modifications to PROEX adopted by Brazil did not constitute the withdrawal of the subsidies, as PROEX was still inconsistent with the prohibition on export subsidies under Article 3.1(a) of the *SCM Agreement*.

5. The Article 21.5 Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 9 May 2000. The Article 21.5 Panel concluded that, as a result of the continued issuance of NTN-I bonds pursuant to letters of commitment issued before 18 November 1999, and as a result of the inconsistency of PROEX as modified with Article 3.1(a) of the *SCM Agreement*, Brazil's measures to comply with the DSB's recommendation either do not exist or are not consistent with the *SCM Agreement*. Accordingly, the Article 21.5 Panel concluded that Brazil has failed to implement the DSB's recommendation that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.[8]

6. On 22 May 2000, Brazil notified the DSB of its intention to appeal certain issues of law covered in the Article 21.5 Panel Report and legal interpretations developed by the Article 21.5 Panel, pursuant to Article 4.8 of the *SCM Agreement* and paragraph 4 of Article 16 of the DSU, and filed a Notice of Appeal pursuant to Rules 20 and 31(1) of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 29 May 2000, Brazil filed its appellant's submission.[9] On

[4]Original panel report, *Brazil – Aircraft*, *supra*, footnote 2, para. 8.4.

[5]*Ibid*., para. 8.5.

[6]Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 2, para. 197.

[7]WT/DS46/13 (26 November 1999).

[8]Article 21.5 Panel Report, para. 7.1.

[9]Pursuant to Rule 21(1) of the *Working Procedures*.

5 June 2000, Canada filed an appellee's submission.[10] On the same day, the European Communities and the United States each filed a third participant's submission.[11]

7. The oral hearing in the appeal was held on 19 June 2000. The participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. Background

8. Before the original panel, the measures at issue were certain export subsidies granted under Brazil's *Programa de Financiamento às Exportações* ("PROEX") on sales of aircraft to foreign purchasers of Empresa Brasileira de Aeronáutica S.A. ("Embraer"), a Brazilian manufacturer of regional aircraft. The original panel described certain factual aspects of PROEX[12] as PROEX existed at that time. We provided a summary of these aspects.[13] The Article 21.5 Panel described the factual aspects of PROEX as revised by Brazil (the "revised PROEX "), in light of the recommendations and rulings of the DSB.[14] Below we provide a summary of the factual aspects of the revised PROEX, based on the summary set out in the Article 21.5 Panel Report.

9. PROEX is administered by the Comitê de Crédito às Exportações (the "Committee"), an inter-agency group within the Ministry of Finance in Brazil. Day-to-day operations of PROEX are conducted by the Bank of Brazil.[15] Under PROEX, the Government of Brazil provides interest rate equalization subsidies for sales by Brazilian exporters, including Embraer, as described below.

10. The financing conditions for which interest rate equalization payments are made are set by Ministerial Decrees. The length of the financing term, which is determined by the product to be exported, varies normally from one year to ten years. In the case of regional aircraft, however, this

[10]Pursuant to Rule 22 of the *Working Procedures*.

[11]Pursuant to Rule 24 of the *Working Procedures*.

[12]Original panel report, *Brazil – Aircraft*, *supra*, footnote 2, paras. 2.1-2.6.

[13]Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 2, paras. 3-6.

[14]Article 21.5 Panel Report, paras. 2.1-2.6. Brazil informed the DSB that it had implemented the recommendations of the DSB through, in addition to Resolution 2667, Newsletter 2881. Newsletter 2881 establishes "the maximum percentages that may be applied under tax rate equalisation systems used for PROEX operations." These maximum percentages cover financing for up to ten years, with the highest interest rate equalization rate set at 2.5 per cent for financing of "over 9 years and up to 10 years". In the First Submission of Brazil to the Panel, however, Brazil indicated that Newsletter 2881 represents "an additional action that does not directly affect the question before this Panel". From this statement, the Article 21.5 Panel concluded that Brazil does not assert that Newsletter 2881 is relevant to its consideration of whether the revised PROEX is consistent with the *SCM Agreement*. Article 21.5 Panel Report, footnote 25. This conclusion was not appealed.

[15]*Ibid*., para. 2.4.

term has often been extended to 15 years, by waiver of the relevant PROEX guidelines. The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to 2.5 percentage points per annum, for a term of nine years or more. Resolution No. 2667 of 19 November 1999 provides that, in respect of regional aircraft financing, "equalisation rates shall be established on a case by case basis and at levels that may be differential, preferably based on the United States Treasury Bond 10-year rate, plus an additional spread of 0.2% per annum, to be reviewed periodically in accordance with market practices."[16] The lending bank charges its normal interest rate for the transaction and receives payment from two sources: the purchaser and the Government of Brazil. In this way, PROEX reduces the financing costs of the purchaser and, thus, reduces the overall cost to the purchaser of purchasing an Embraer aircraft.

11. The involvement of PROEX in aircraft financing transactions begins when the manufacturer – Embraer – requests approval for PROEX interest rate equalization subsidies before the conclusion of a formal contract with a buyer. If the Committee approves the request, it then issues a letter of commitment to the manufacturer, committing the Government of Brazil to PROEX support, provided that the buyer and the manufacturer conclude a contract for the transaction within a specified period of time, usually 90 days (subject to renewal), and in accordance with the terms and conditions set forth in the original request.[17] The letter of commitment usually provides that PROEX payments will be made in 30 equal and consecutive semi-annual instalments during a financing period of 15 years. The first instalment payment is typically due six months after the delivery date of each aircraft.[18]

12. PROEX interest rate equalization payments begin after the aircraft is exported. The payments are made in the form of bonds issued by PROEX to the financing institution. After each export transaction is confirmed, the Bank of Brazil applies to the National Treasury of Brazil for the issuance of bonds designated as National Treasury Note – Series I ("NTN-I") bonds. The National Treasury issues these bonds and transfers them to the Bank of Brazil, which in turn passes the bonds to the lending bank (or its agent bank). The lending bank can redeem the bonds on a semi-annual basis for the duration of the financing, or can sell them on the market at a discount immediately upon receipt.[19]

[16]Article 21.5 Panel Report, para. 2.3.

[17]*Ibid*., para. 2.5.

[18]*Ibid*., para. 2.6.

[19]*Ibid*.

NTN-I bonds are denominated in Brazilian currency, indexed to the dollar as of the date the bonds are issued. The bonds can only be redeemed in Brazil, and only in Brazilian currency.[20]

III. Arguments of the Participants and the Third Participants

A. *Claims of Error by Appellant – Brazil*

1. Issuance of NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999

13. Brazil argues that, contrary to the Article 21.5 Panel's findings, the continued issuance of NTN-I bonds pursuant to commitments made prior to the modification of PROEX is consistent with the *SCM Agreement*. In particular, Brazil submits that the subsidies in question have already been "granted" within the meaning of Article 3.2 of the *SCM Agreement*, and therefore no remedy is available under Article 3 for these subsidies. Brazil contends that the Article 21.5 Panel erred in concluding that PROEX interest equalization payments for regional aircraft are "granted" upon the issuance of NTN-I bonds, regardless of *when* the aircraft were sold. The Article 21.5 Panel improperly found that the timing of the "grant" of an export subsidy for the purpose of Article 3.2 of the *SCM Agreement* is legally distinct from the timing of when a subsidy is "conferred" under Article 1 of that Agreement.

14. In Brazil's view, the Article 21.5 Panel should have determined that a subsidy is "granted" when Brazil makes a "financial contribution" and a benefit is thereby "conferred". This occurs when a letter of commitment is issued and the transaction is finalized by a contract made pursuant to that commitment. Thus, for contracts that were signed before 18 November 1999, the subsidy has already been "granted" within the meaning of Article 3.2. Therefore, these subsidies are not subject to the DSB's recommendation to "withdraw" the prohibited export subsidies.

2. Are Export Subsidies under PROEX "Permitted" under Item (k) of the Illustrative List?

15. Brazil argues that subsidies under the revised PROEX are "permitted" under item (k) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* (the "Illustrative List"). Brazil argues that the Article 21.5 Panel erred in concluding that the first paragraph of item (k) may not be interpreted "*a contrario*" to establish that a subsidy is "permitted". According to Brazil, if subsidies of the type defined in the first paragraph of item (k) are "used to secure a material advantage in the field of export credit terms", they constitute prohibited export subsidies. If, by contrast, they

[20]Article 21.5 Panel Report, para. 2.6.

are not "used to secure a material advantage in the field of export credit terms", then they do not constitute prohibited export subsidies under the *SCM Agreement*.

16. Brazil considers that the Article 21.5 Panel erred in concluding that the "material advantage" clause in the first paragraph of item (k) cannot be used to establish that an export subsidy is "permitted". The Article 21.5 Panel's reliance on footnote 5 of the *SCM Agreement* ignores the ordinary meaning of the text of item (k). The Article 21.5 Panel should have interpreted the "material advantage" clause "*a contrario*" and concluded that a payment that is *not* "used to secure a material advantage" is *not prohibited* under the *SCM Agreement*; in other words, that such a subsidy is "permitted".

17. Brazil notes that the first paragraph of item (k) applies, *inter alia*, to the "payment [by governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits". Brazil contends that the Article 21.5 Panel erred in concluding that PROEX payments are not "payments" within the meaning of the first paragraph of item (k). According to Brazil, the Article 21.5 Panel made two errors on this issue. The terms of the first paragraph of item (k) should not be interpreted narrowly so that financial institutions are not considered to incur costs in obtaining export credits. The fact that an exporter or a financial institution *provides* credits does not mean that it does not *obtain* them at a cost. Furthermore, the Article 21.5 Panel failed to distinguish between situations in which the lender is a financial institution *outside* Brazil and situations in which the lender is a financial institution *inside* Brazil.

18. According to Brazil, the Article 21.5 Panel erred in its conclusion that Brazil failed to demonstrate that PROEX subsidies are not "used to secure a material advantage in the field of export credit terms." In particular, the Article 21.5 Panel incorrectly held that an interest rate that results from a government guarantee, which Brazil submitted as evidence of the market for export credits, can never be a "commercial" rate. This conclusion is contradicted by the undisputed evidence in the Article 21.5 Panel record that rates supported by government guarantees are very much a part of the market. Neither the Article 21.5 Panel nor Canada pointed to any evidence of any commercial aircraft export financing not supported in some way by a government. The Article 21.5 Panel should have found that the term "commercial" for the purposes of assessing material advantage means any market rate that is not inconsistent with the *SCM Agreement*. The Article 21.5 Panel also erred by concluding that floating rate transactions were not relevant to an evaluation of the question of whether PROEX was "used to secure a material advantage in the field of export credit terms."

19. Furthermore, Brazil states, the Article 21.5 Panel erred in placing on Brazil the burden of proving that its measure implements the recommendations and rulings of the DSB, rather than placing on Canada the burden of proving that the measure does not implement them. The Article 21.5 Panel's

reversal of the burden of proof was contrary to the holding of the Appellate Body in *Chile – Taxes on Alcoholic Beverages* ("*Chile – Alcoholic Beverages*")[21], which attaches a presumption of compliance to the measures taken by Members to implement DSB recommendations and rulings. Finally, Brazil argues that the Article 21.5 Panel applied an erroneous presumption of correctness to unsupported statements made by Canada regarding interest rates actually applied by Canada.

B. *Arguments by Appellee – Canada*

1. Issuance of NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999

20. According to Canada, it is undisputed that Brazil took no steps to modify pre-existing PROEX letters of commitment pertaining to aircraft exported after 18 November 1999, and that Brazil continues to issue NTN-I bonds to provide interest equalization payments on aircraft exported after 18 November 1999 pursuant to the terms and conditions in letters of commitment issued before that date. The Article 21.5 Panel was consequently correct in finding that Brazil has failed to "withdraw" the prohibited export subsidies, as it continues to "grant" these subsidies. Whatever else "withdraw" may mean, at a minimum it must encompass ceasing to "grant or maintain" prohibited subsidies under Article 3.2 of the *SCM Agreement*, as Brazil continues to do.

21. Contrary to Brazil's assertion, Canada argues that the plain language and the structure of the *SCM Agreement* supports the Article 21.5 Panel's conclusion that the issue of whether a subsidy "exists" is legally distinct from the issue of when a subsidy is "granted" for the purpose of Article 3.2, and that PROEX subsidies are "granted" at the time the NTN-I bonds are issued. Moreover, as the Article 21.5 Panel observed, acceptance of Brazil's claim would permit a WTO Member, up to the final day of the implementation period, to contract to "grant" prohibited subsidies for years into the future and be insulated from any meaningful remedy under the WTO dispute settlement system.

2. Are Export Subsidies under PROEX "Permitted" under Item (k) of the Illustrative List?

22. Canada argues that the Article 21.5 Panel was correct in its finding that PROEX subsidies are not "permitted" under item (k) of the Illustrative List. Canada refers to Brazil's argument that the Article 21.5 Panel erred in concluding that the language in the first paragraph of item (k) cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is "permitted". Canada notes that this argument is at the core of Brazil's claim that the revised PROEX is in compliance with the *SCM Agreement*.

[21]WT/DS87/AB/R, WT/DS110/AB/R, adopted 12 January 2000, para. 74.

23. Canada submits that the Article 21.5 Panel correctly determined that the first paragraph of item (k) does not create such an "*a contrario*" exception. While Brazil urges that the Article 21.5 Panel should have looked only to the language of item (k) itself, Canada argues that the Article 21.5 Panel rightly began by interpreting the text of Article 3 and footnote 5 of the *SCM Agreement*, which contain the prohibition on, and the parameters of any exception to, the prohibition on export subsidies. In particular, the Article 21.5 Panel determined that, in its ordinary meaning, footnote 5 provides a textual basis for deciding when the Illustrative List can be used to demonstrate that a practice included in the Illustrative List is not a prohibited export subsidy. The Article 21.5 Panel correctly determined that only the provisions of the Illustrative List that affirmatively state that a practice is not an export subsidy fall within the scope of footnote 5, when read in conformity with its ordinary meaning. The first paragraph of item (k) does not contain such an affirmative statement. Therefore, in Canada's view, it does not create an exception to the prohibition in Article 3.

24. Canada notes that Brazil alleges the Article 21.5 Panel erred in concluding that PROEX payments are not "payments" within the meaning of the first paragraph of item (k) of the Illustrative List. Brazil disagrees with the Article 21.5 Panel's factual conclusion that financing institutions involved in financing PROEX-supported transactions that provide export credits cannot be seen as *obtaining* such credits. According to Canada, however, the Article 21.5 Panel's conclusion follows from the ordinary meaning of the text of item (k) as applied to PROEX payments, which, as found in the original proceedings, are made to reduce interest rates below market rates rather than to reimburse borrowing costs.

25. Canada also submits that the Article 21.5 Panel was not convinced, as argued by Brazil, that PROEX payments serve to reimburse costs incurred by financing institutions in obtaining credits. It found as an undisputed fact that the financial institutions receiving PROEX payments are in many cases leading international institutions which do not incur the additional costs faced by Brazilian financial institutions. Moreover, both the Article 21.5 Panel and the Appellate Body in the original proceedings had concluded that PROEX payments are payments to reduce the interest rate paid by purchasers of the aircraft. Canada argues that PROEX payments, in this context, do nothing to reduce the cost of obtaining credits for Brazilian financing institutions.

26. According to Canada, Brazil's claim, that the Article 21.5 Panel erred in several respects in finding that payments under the revised PROEX are "used to secure a material advantage to the field of export credit terms" is unfounded. In light of the Appellate Body's earlier analysis of "material advantage", the Article 21.5 Panel's task was to measure PROEX supported interest rates in relation to *commercial* rates that might be available in the marketplace. The Article 21.5 Panel's refusal to consider a transaction supported by a loan guarantee provided by the Export-Import Bank of the

United States as evidence of such commercial interest rates was correct because, by its very nature, a government-guaranteed loan cannot be considered to be made at a commercial rate.

27. In addition, the Article 21.5 Panel correctly determined that, in the circumstances of this case, floating rate transactions were not relevant as evidence of the market for fixed interest rates. According to Canada, Brazil could not explain what minimum rate it would apply if it provided PROEX payments in support of floating interest rates. In these circumstances, the Article 21.5 Panel had no choice but to disregard the floating rate transaction example provided by Brazil.

28. Furthermore, contrary to Brazil's allegation, the Article 21.5 Panel appropriately allocated the burden of proof at every stage of the proceeding. Brazil's argument completely mischaracterizes the finding of the Appellate Body in *Chile – Alcoholic Beverages*. The issue here has nothing to do with Brazil's previous measures or with presuming that Brazil is acting in bad faith, but rather with its failure to meet the burden of proof on an "affirmative defence". It was for Brazil to demonstrate that the market provided interest rates at the level of those resulting from the application of PROEX payments. Brazil did not prove that such rates exist.

C. *Arguments of the Third Participants*

1. European Communities

29. The European Communities begins its submission with comments on the agreement reached between Brazil and Canada, in this dispute, on, *inter alia*, the conduct of the procedure under Article 21.5 of the DSU. Although the European Communities accepts that parties may make agreements relating to procedural issues in dispute settlement proceedings, such agreements may not, in its view, affect the rights of third parties. The European Communities is concerned that, in certain disputes under Article 21.5, parties have agreed bilaterally to dispense with formal consultations under Article 4 of the DSU. The European Communities considers this to be inconsistent with the DSU and to prejudice third party rights. The European Communities recognizes that this issue was not raised before the Article 21.5 Panel and is not the subject of an appeal. However, the European Communities considers that it would be useful to all Members to have a ruling on this issue and would appreciate a statement from the Appellate Body to the effect that "the parties to a dispute may not enter into agreements regarding the conduct of dispute settlement proceedings that prejudice the rights and interests of other Members, in particular to participate as third parties."[22]

[22]European Communities' third participant's submission, para. 15.

(a) Issuance of NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999

30. According to the European Communities, the Article 21.5 Panel's finding that Brazil has not withdrawn PROEX subsidies made pursuant to letters of commitment issued before 18 November 1999 was correct, as Brazil continues to "grant" those subsidies within the meaning of Article 3.2 of the *SCM Agreement*. The subsidies are "granted" for the purposes of Article 3.2 when the NTN-I bonds are issued, rather than when the letters of commitment are issued. When the subsidy "exists" under Article 1 is not relevant to this issue.

(b) Are Export Subsidies under PROEX "Permitted" under Item (k) of the Illustrative List?

31. The European Communities agrees with the Article 21.5 Panel's finding that the relationship between the prohibition contained in Article 3.1(a) of the *SCM Agreement* and the Illustrative List is governed exclusively by footnote 5. The interpretation "*a contrario*" of items in the Illustrative List, even in the qualified manner proposed by the United States, would read footnote 5 out of the *SCM Agreement*. Moreover, Brazil does not explain why the drafters would have restricted the scope of footnote 5 to only some of the measures in the Illustrative List.

32. The European Communities agrees with the Article 21.5 Panel's finding that a Member may demonstrate through positive evidence that a net interest rate below the relevant Commercial Interest Reference Rate ("CIRR") established by the *Arrangement on Guidelines for Officially Supported Export Credits* (the "*OECD Arrangement*") is not "used to secure a material advantage in the field of export credit terms". The European Communities considers, nevertheless, that the Article 21.5 Panel failed to formulate and apply the appropriate benchmark in order to assess whether an interest rate below the CIRR secures a "material advantage". According to the Article 21.5 Panel, the relevant benchmark would be the "minimum commercial interest rate" available in the marketplace, which the Article 21.5 Panel considered to exclude any officially supported rates. In the European Communities' view, the appropriate benchmarks are the interest rates available in the marketplace, irrespective of whether those interest rates are officially supported.

33. However, the European Communities agrees with the Article 21.5 Panel's conclusion that Brazil did not meet its burden of proving that the benchmark that it established, the 10-year United States Treasury Bond rate plus a spread of 20 basis points, is appropriate. The example provided by Brazil of a floating rate transaction guaranteed by the Export-Import Bank of the United States did not constitute, as rightly concluded by the Article 21.5 Panel, relevant evidence, since floating rates are not directly comparable to fixed rates.

2. United States

(a) Issuance of NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999

34. The United States submits that in the context of this case, the Article 21.5 Panel's conclusion, that the continued issuance of NTN-I bonds pursuant to letters of commitment issued before 18 November 1999 is not consistent with the recommendation of the DSB to "withdraw" the subsidies pursuant to Article 4.7 of the *SCM Agreement*, was correct. Therefore, the United States believes that the Appellate Body should affirm the Article 21.5 Panel's ultimate conclusion. The United States notes, however, that it considers that the issue of when the subsidy "exists" under Article I of the *SCM Agreement* is not relevant to the question of Brazil's obligation to "withdraw" the subsidies found to be prohibited and to refrain from "granting" or "maintaining" such subsidies.

(b) Are Export Subsidies under PROEX "Permitted" under Item (k) of the Illustrative List?

35. As argued during previous stages of this dispute, the United States considers that the Appellate Body should reverse the Article 21.5 Panel's interpretation regarding the "*a contrario*" issue. The United States refers to its prior arguments on this issue. In addition, the United States disagrees with the following statement of the Article 21.5 Panel: "We agree with Brazil that the *SCM Agreement* should not be interpreted in a manner that provides special and *less* favourable treatment for developing country Members in the field of export credit terms if the text of the Agreement permits of an alternative interpretation."[23] The United States submits that there is no basis for employing this consideration as a method of interpretation.

36. The United States then argues that Brazil is incorrect when it argues that any rate offered by a commercial bank which is supported by a government-supplied loan guarantee that is consistent with the *SCM Agreement* is a "commercial" rate. In the view of the United States, the fact that a government-supplied loan guarantee is consistent with item (j) of the Illustrative List does not mean that the financing that is being guaranteed is "commercial". It simply means that the transaction does not constitute a prohibited export subsidy.

37. Furthermore, the Article 21.5 Panel erred by imposing on Brazil the burden of proving that PROEX, as revised, is not "used to secure a material advantage in the field of export credit terms." The United States considers that neither item (k) nor any other of the items in the Illustrative List constitutes an "affirmative defence." Instead, item (k) describes the legal standard that Canada, as the complainant, must demonstrate that Brazil has violated.

[23]Article 21.5 Panel Report, para. 6.47.

IV. Issues Raised in this Appeal

38. The following issues are raised in this appeal:

(a) whether the continued issuance of NTN-I bonds, pursuant to letters of commitment issued before 18 November 1999, under the terms and conditions of PROEX as it existed before it was revised, is consistent with the recommendation of the DSB, made pursuant to Article 4.7 of the *SCM Agreement*, to withdraw the measures found to be prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement*; and

(b) whether payments made under PROEX, as revised by Brazil, are "permitted" under Item (k) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* (the "Illustrative List").

V. Issuance of NTN-I Bonds Pursuant to Letters of Commitment Issued before 18 November 1999

39. Canada's complaint, on this issue, is limited to the claim that Brazil has failed to "withdraw" the prohibited export subsidies under PROEX that were found by the original panel to be inconsistent with Article 3.1(a) of the *SCM Agreement*. Canada alleges that Brazil has continued, *after* the 90-day period of implementation which ended on 18 November 1999, to issue NTN-I bonds, pursuant to letters of commitment issued *before* 18 November 1999, on the basis of the terms and conditions of PROEX as that programme existed before Brazil revised it.

40. The Article 21.5 Panel found that the continued issuance of NTN-I bonds, pursuant to letters of commitment issued *before* 18 November 1999, represents the "grant" of subsidies contingent upon export performance inconsistent with the provisions of Article 3.2 of the *SCM Agreement.* The Article 21.5 Panel noted the finding by the original panel that export subsidies under PROEX are "granted", within the meaning of Article 27.4 of the *SCM Agreement*, when the NTN-I bonds are issued, and also noted that the Appellate Body had confirmed this finding.[24] In the Article 21.5 Panel's view, there was no basis on which to attribute a different meaning to the term "grant" in Article 3.2 of the *SCM Agreement* than that attributed to the word "grant" in Article 27.4 of that Agreement. Therefore, the Article 21.5 Panel reasoned that the issuance of NTN-I bonds by Brazil constitutes the "grant" of prohibited export subsidies within the meaning of Article 3.2.[25] Accordingly, the Article 21.5 Panel concluded that by continuing to "grant" prohibited export

[24]Article 21.5 Panel Report, para. 6.10.

[25]*Ibid*., para. 6.11.

subsidies through the continued issuance of NTN-I bonds, Brazil has failed to implement the recommendation of the DSB that it "withdraw" these export subsidies for regional aircraft under PROEX within 90 days, that is, by 18 November 1999.[26]

41. On appeal, Brazil argues that the Article 21.5 Panel erred in finding that the continued issuance of NTN-I bonds, pursuant to letters of commitment issued *before* 18 November 1999, represents the "grant" of subsidies contingent upon export performance. Brazil argues that the *issuance* of the NTN-I bonds does not involve the "grant" of "PROEX subsidies", because "PROEX subsidies" are "granted" at an earlier stage. Brazil contends that "PROEX subsidies are granted when the Government of Brazil makes a financial contribution 'and a benefit is thereby conferred'" [27]; that is, the subsidies are "granted" when they are deemed to "exist" under Article 1. According to Brazil, "this occurs when a letter of commitment is issued and the transaction is finalized by a contract made pursuant to that commitment." [28] As a result, Brazil maintains that the continued issuance of NTN-I bonds after 18 November 1999, pursuant to these "previous PROEX commitments"[29], does not involve the "granting" of prohibited export subsidies which it is obliged to "withdraw".

42. We recall the conclusion of the original panel that "payments on exports of regional aircraft under the PROEX interest rate equalization scheme are export subsidies inconsistent with Article 3 of the SCM Agreement".[30] On appeal, we upheld this conclusion of the original panel.[31] As a result, the DSB recommended that Brazil withdraw the prohibited export subsidies under PROEX within 90 days, that is, by 18 November 1999.

43. With respect to letters of commitment issued before 18 November 1999, Canada's complaint is limited to its allegation that Brazil has failed to "withdraw" the measure found to involve prohibited export subsidies because Brazil has continued to issue NTN-I bonds, *after* 18 November 1999.[32] We are not asked, in our examination of this issue, to address any other aspect of Brazil's obligation to "withdraw" the measures found to be prohibited export subsidies pursuant to the recommendation of the DSB.

44. We do not believe that Brazil's arguments about when a subsidy is deemed to "exist" under Article 1.1 of the *SCM Agreement*, and when it is "granted" under Article 3.2 of that Agreement, are

---

[26]Article 21.5 Panel Report, para. 6.17.

[27]Brazil's appellant's submission, para. 18.

[28]*Ibid*.

[29]*Ibid*., p. 4, Heading III.

[30]Original panel report, *Brazil – Aircraft*, *supra*, footnote 2, para. 8.2.

[31]Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 2, para. 197.

[32]*Supra*, para. 39.

relevant to our inquiry into the issue before us. The export subsidies under PROEX that are at issue in this appeal were found, by the original panel and by us, to be prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement*. The existence of a "subsidy" was not contested by Brazil in the proceedings before the original panel[33]; and Brazil also conceded before the original panel that subsidies under PROEX were export contingent.[34] The only issue before us now is whether the continued issuance of NTN-I bonds by Brazil *after* 18 November 1999, pursuant to letters of commitment issued *before* 18 November 1999, is consistent with the recommendation of the DSB to "withdraw" the prohibited export subsidies within 90 days.

45. Turning to the ordinary meaning of "withdraw", we observe first that this word has been defined as "remove" or "take away"[35], and as "to take away what has been enjoyed; to take from."[36] This definition suggests that "withdrawal" of a subsidy, under Article 4.7 of the *SCM Agreement*, refers to the "removal" or "taking away" of that subsidy. We observe also that Brazil concedes that it has taken *no action* to implement the recommendation of the DSB with respect to transactions relating to NTN-I bonds issued pursuant to letters of commitment issued before 18 November 1999.[37] In this respect, the Article 21.5 Panel stated that "Brazil does not deny that it continues to issue NTN-I bonds in respect of commitments made prior to 18 November 1999."[38] Thus, NTN-I bonds continue to be issued, after 18 November 1999, on precisely the same terms and conditions as they were before. These bonds, in essence, represent disbursements made under PROEX. The financing institution can choose either to sell the bonds in the market or simply receive payments as they become due.[39] Thus, Brazil is continuing to make payments, after 18 November 1999, under a subsidy programme found to involve prohibited export subsidies inconsistent with Article 3.1(a) of the *SCM Agreement*, namely the PROEX programme as previously constituted. In our view, to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away". Thus, we find that the recommendation of the DSB requires Brazil to stop issuing NTN-I

[33]Original panel report, *Brazil – Aircraft*, *supra*, footnote 2, para. 7.12.

[34]*Ibid*.

[35]*Concise Oxford English Dictionary* (Clarendon Press, 1995), p. 1609.

[36]*Black's Law Dictionary* (West Publishing, 1990), p. 1602

[37]Article 21.5 Panel Report, para. 6.7.

[38]*Ibid*.

[39]See, *supra*, para. 12.

bonds as from 18 November 1999 pursuant to letters of commitment issued before 18 November 1999.[40]

46. We note Brazil's argument before the Article 21.5 Panel that Brazil has a contractual obligation under domestic law to issue PROEX bonds pursuant to commitments that have already been made, and that Brazil could be liable for damages for breach of contract under Brazilian law if it failed to respect its contractual obligations.[41] In response to a question from us at the oral hearing, however, Brazil conceded that a WTO Member's domestic law does not excuse that Member from fulfilling its international obligations. Like the Article 21.5 Panel,[42] we do not consider that any private contractual obligations, which Brazil may have under its domestic law, are relevant to the issue of whether the DSB's recommendation to "withdraw" the prohibited export subsidies permits the continued issuance of NTN-I bonds under letters of commitment issued before 18 November 1999.

47. For all these reasons, we uphold the Article 21.5 Panel's conclusion that Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies on sales of regional aircraft under PROEX pursuant to letters of commitment issued before 18 November 1999.

VI. Are Export Subsidies under PROEX "Permitted" under Item (k) of the Illustrative List?

A. *Introduction*

48. The original panel found that export subsidies under PROEX are prohibited under Article 3.1(a) of the *SCM Agreement*, and we upheld this finding. The DSB recommended that Brazil "withdraw" these prohibited subsidies, pursuant to Article 4.7 of the *SCM Agreement*, by 18 November 1999. Brazil elected to implement the recommendation of the DSB by revising PROEX. Canada claims, in this aspect of these Article 21.5 proceedings, that Brazil has not "withdrawn" the prohibited export subsidies, as recommended by the DSB, because the revised

[40]We recall that, in paragraph 18 of its appellant's submission, Brazil referred to the "finalization" of the contract made pursuant to a letter of commitment, as well as to the issuance of the letter of commitment itself (see, *supra*, para. 41). We note that our conclusion, in paragraph 45, is based on the date when the NTN-I bonds are issued, and not on the date when the letter of commitment is issued or when the contract is "finalized". For our reasoning, it is not relevant whether the letter of commitment was or was not "finalized" by a contract signed before 18 November 1999.

[41]Article 21.5 Panel Report, para. 6.16.

[42]*Ibid*.

PROEX is not consistent with Brazil's obligations under Article 3.1(a) of the *SCM Agreement*.[43] Brazil maintains, in response, that the revised PROEX is justified by item (k) of the Illustrative List.[44]

49. The original panel found, and Brazil did not contest, that PROEX involves "subsidies" within the meaning of Article 1 of the *SCM Agreement* that are "contingent upon export performance" within the meaning of Article 3.1(a) of that Agreement.[45] The Article 21.5 Panel noted that Brazil did not suggest that the modifications Brazil has since made to PROEX mean that the revised PROEX does not involve export subsidies under Article 3.1(a).[46] Rather, Brazil maintains in these Article 21.5 proceedings that the export subsidies under the revised PROEX are justified by item (k) of the Illustrative List.[47] In this respect, the Article 21.5 Panel also stated that Brazil acknowledged that it is asserting, through its reliance on item (k), an alleged "affirmative defence", and that, therefore, the burden of establishing entitlement to that "defence" is on Brazil.[48]

50. To determine whether Brazil was entitled to the benefit of such a "defence", the Article 21.5 Panel considered the following issues. First, the Article 21.5 Panel stated that Brazil's "defence" depends upon the proposition that the first paragraph of item (k) may be used to establish that an export subsidy within the meaning of item (k) is "permitted" by the *SCM Agreement*. Then, the Article 21.5 Panel stated that Brazil's "defence" depends upon Brazil establishing: (a) that PROEX payments are "the payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the first paragraph of item (k); and (b) that PROEX payments are not "used to secure a material advantage in the field of export credit terms."[49]

51. The Article 21.5 Panel stated that Brazil's argument "depends upon" Brazil succeeding in its legal and factual arguments on *all three of these issues*.[50] Thus, if Brazil had failed to meet its burden of proof on *any one* of these issues, the Article 21.5 Panel could have rejected Brazil's argument on that basis alone. The Article 21.5 Panel stated that "[i]n this Article 21.5 dispute, however, we have decided to address all three elements of Brazil's defence. In our view, this more comprehensive approach will provide a greater degree of clarity and guidance to the parties in

[43]Article 21.5 Panel Report, para. 6.3.

[44]*Ibid*.

[45]Original panel report, *Brazil – Aircraft, supra*, footnote 2, paras. 7.12 and 7.15.

[46]Article 21.5 Panel Report, para. 6.21.

[47]*Ibid*., para. 6.22.

[48]*Ibid*.

[49]*Ibid*.

[50]*Ibid*.

respect of implementation."[51] The Article 21.5 Panel, therefore, examined each of these three issues, and subsequently found that Brazil had not met its burden of proof on any of them. Consequently, the Panel concluded that the revised PROEX was not justified by item (k), and that, therefore, Brazil had not implemented the recommendation of the DSB that it "withdraw" its export subsidies under PROEX within 90 days.

52. Having stated the Article 21.5 Panel's conclusions, we think it useful to summarize the Article 21.5 Panel's reasoning on each of these three issues.

53. As we have noted, the first issue is whether the first paragraph of item (k) of the Illustrative List may be interpreted such that payments *not* "used to secure a material advantage in the field of export credit terms" are "permitted" under the *SCM Agreement*. In examining this issue, the Article 21.5 Panel emphasized the importance of footnote 5 to Article 3.1(a). Footnote 5 provides that: "Measures *referred to in Annex I as not constituting export subsidies* shall not be prohibited under this or any other provision of this Agreement." (emphasis added) The Article 21.5 Panel said that: "In its ordinary meaning, footnote 5 relates to situations where a measure is referred to as *not* constituting an export subsidy."[52] The Article 21.5 Panel found that:

> The first paragraph of item (k) … does not contain any affirmative statement that a measure is *not* an export subsidy nor that measures not satisfying the conditions of that item are *not* prohibited. To the contrary, the first paragraph of item (k) on its face simply identifies measures that *are* prohibited export subsidies. Thus, the first paragraph of item (k) on its face does not in our view fall within the scope of footnote 5 read in conformity with its ordinary meaning.[53]

The Article 21.5 Panel concluded that the first paragraph of item (k) cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is "permitted".[54]

54. The second issue considered by the Article 21.5 Panel was whether export subsidies under the revised PROEX constitute the "payment" by Brazil "of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the first paragraph of item (k). The Article 21.5 Panel found as follows:

---

[51]Article 21.5 Panel Report, para. 6.23.

[52]*Ibid*., para. 6.36.

[53]*Ibid*., para. 6.37.

[54]*Ibid*., para. 6.67. The Article 21.5 Panel repeated this conclusion in para. 6.106(ii).

> While the financial institutions involved in financing PROEX-supported transactions certainly *provide* export credits, they cannot be seen as *obtaining* such credits. … In short, we do not agree that payments to a lender that amount to interest rate support can reasonably be understood to be payments of all or part of the costs of obtaining export credits.[55]

55. The third issue considered by the Article 21.5 Panel was whether export subsidies under the revised PROEX are "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k) of the Illustrative List. The Article 21.5 Panel said that:

> … a Member may under the first paragraph of item (k) as interpreted by the Appellate Body establish that a payment was not used to secure a material advantage in the field of export credit terms, even if it resulted in a below-CIRR interest rate, if it could establish that the net interest rate resulting from the payment was not lower than the minimum *commercial* interest rate in respect of that currency.[56]

56. In its reasoning on this third issue, the Article 21.5 Panel considered evidence presented by Brazil in support of its argument.[57] The Panel examined the evidence and concluded "that Brazil has failed to demonstrate that PROEX payments are not 'used to secure a material advantage in the field of export credit terms' within the meaning of the first paragraph of item (k)."[58]

57. On appeal, Brazil argues that the Article 21.5 Panel erred in its findings on all three of these issues, and erred also in its finding that the burden of proof under item (k) is on Brazil. First, with regard to whether the first paragraph of item (k) may be used as a basis for arguing that certain export subsidies are "permitted", Brazil submits that the Article 21.5 Panel's reliance on footnote 5 was misplaced. Brazil emphasizes, first of all, that its argument that subsidies under the revised PROEX are "permitted" was not based on footnote 5 but rather on an "*a contrario*" interpretation of the text of the first paragraph of item (k).[59] Second, Brazil argues that the Article 21.5 Panel erred in its finding that Brazil failed to demonstrate that subsidies under the revised PROEX are the "payment" by governments "of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the first paragraph of item (k).[60] And, third, Brazil argues that the

[55]Article 21.5 Panel Report, para. 6.72.

[56]*Ibid*., para. 6.92.

[57]*Ibid*., paras. 6.94-6.105.

[58]*Ibid*., para. 6.106.

[59]Brazil's appellant's submission, para. 26.

[60]*Ibid*., paras. 35-48.

Article 21.5 Panel erred in finding that Brazil failed to demonstrate that subsidies under the revised PROEX are *not* "used to secure a material advantage in the field of export credit terms." On this third issue, Brazil asserts that the Article 21.5 Panel erred in concluding that a net interest rate that "results from a government guarantee" is not a "commercial" rate.[61] On this issue, in addition, Brazil argues that the Article 21.5 Panel erred in rejecting evidence of a floating rate transaction as irrelevant to a fixed rate transaction.[62] Furthermore, Brazil submits that the Article 21.5 Panel reversed the burden of proof by requiring Brazil to demonstrate that subsidies under the revised PROEX are *not* "used to secure a material advantage in the field of export credit terms."[63]

58. Having stated the Article 21.5 Panel's conclusions, having summarized the Article 21.5 Panel's reasoning in reaching those conclusions, and having summarized Brazil's arguments on appeal with respect to those conclusions, we turn now to our own analysis of these three issues. We note at the outset that we agree with the Article 21.5 Panel that in order for Brazil to establish its alleged "affirmative defence", Brazil must succeed in its legal and factual arguments on *each* of the three issues examined by the Article 21.5 Panel. Thus, if Brazil is unsuccessful in proving *any one* of these three issues, Brazil's alleged "affirmative defence" under item (k) fails. With this in mind, we begin our analysis by addressing the last issue dealt with by the Article 21.5 Panel, that is, whether subsidies under the revised PROEX are "used to secure a material advantage in the field of export credit terms."

B. *Are export subsidies under PROEX "used to secure a material advantage in the field of export credit terms"*?

59. In addressing this issue, we begin by recalling that, in this aspect of its complaint, Canada claims that Brazil has not "withdrawn" the prohibited export subsidies, as required by the DSB recommendation made pursuant to Article 4.7 of the *SCM Agreement*, because the revised PROEX is not consistent with Brazil's obligations under Article 3.1(a) of the *SCM Agreement*. Thus, it follows that this aspect of these Article 21.5 proceedings covers only the measures taken by Brazil for the purpose of "withdrawing" the prohibited export subsidy measure through revising the PROEX programme.

[61]Brazil's appellant's submission, para. 51.

[62]*Ibid*., para. 58.

[63]*Ibid*., paras. 60-61.

60. The first paragraph of item (k) of the Illustrative List reads as follows:

> The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or *the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms*. (emphasis added)

61. The first paragraph of item (k) contains examples – illustrations – of certain kinds of export credit practices that constitute prohibited export subsidies under Article 3.1(a) of the *SCM Agreement*. One of these examples, or illustrations, relates to the "payment by [governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits". Such "payments" are considered to be export subsidies under item (k) "in so far as they are used to secure a material advantage in the field of export credit terms." In our Report in *Brazil – Aircraft*, we examined the meaning of this "material advantage" clause in item (k). We ruled in that Report that the determination of whether a payment is "used to secure a material advantage" calls for a comparison between the export credit terms available under the measure at issue and some other "market benchmark".[64] We stated that "we see the second paragraph of item (k) as useful context for interpreting the 'material advantage' clause in the text of the first paragraph".[65] And, in this respect, we identified the Commercial Interest Reference Rate (the "CIRR"), defined in the *Arrangement on Guidelines for Officially Supported Export Credits* (the "*OECD Arrangement*"), as an "appropriate" "market benchmark" for assessing whether a payment "is used to secure a material advantage".[66] We explained:

> … the *OECD Arrangement* can be appropriately viewed as *one example* of an international undertaking providing a *specific market benchmark* by which to assess whether payments by governments, coming within the provisions of item (k), are 'used to secure a material advantage in the field of export credit terms'.[67] (emphasis added)

---

[64]Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 2, para. 181.

[65]*Ibid*.

[66]*Ibid*.

[67]*Ibid*.

62. We also indicated, in that Report, that the CIRR represents the *minimum* authorized interest rate that can be offered to borrowers in officially-supported export credit transactions under the *OECD Arrangement*.[68] We then noted that:

> The fact that a particular *net* interest rate is below the relevant CIRR is a *positive indication* that the government payment in that case has been 'used to secure a material advantage in the field of export credit terms'.[69] (emphasis added)

63. The Article 21.5 Panel correctly concluded from our Report in *Brazil – Aircraft* that "the CIRR was not intended as the exclusive and immutable benchmark applicable in all cases."[70] The Article 21.5 Panel then stated that:

> … we consider that a Member may under the first paragraph of item (k) as interpreted by the Appellate Body establish that a payment was not used to secure a material advantage in the field of export credit terms, *even if it resulted in a below-CIRR interest rate*, …[71] (emphasis added)

64. We agree with this legal interpretation by the Article 21.5 Panel of the "material advantage" clause in item (k). Again, as we said in our Report in *Brazil – Aircraft*, the CIRR is "*one example*" of a "market benchmark" that may be used to determine whether a "payment" is used to "secure a material advantage". (emphasis added) The CIRR is a constructed interest rate for a particular currency, at a particular time, that does not always necessarily reflect the actual state of the credit markets.[72] Where the CIRR does not, in fact, reflect the rates available in the marketplace, we believe that a Member should be able, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions.[73] Thus, the CIRR is not, necessarily, the *sole* "market benchmark" that may be used to determine whether a payment "is used to secure a material advantage in the field of export credit terms", within the meaning of item (k) of the Illustrative List.

---

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

[69]Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 2, para. 182.

[70]Article 21.5 Panel Report, para. 6.84.

[71]*Ibid*., para. 6.92.

[72]The CIRR is constructed on the basis of the rules and principles set out in Articles 15 and 16 of the *OECD Arrangement*.

[73]See, further, *infra*, para. 73. We note that it is not necessary for us to address, in these proceedings, whether transactions involving government intervention, such as government loan guarantees, can provide evidence of an appropriate "market benchmark", *below* the CIRR, to determine whether "payments", under item (k), are "used to secure a material advantage in the field of export credit terms."

65. Before addressing the issue of the application of the "material advantage" clause in this case, though, we must first examine the issue of burden of proof under item (k). The Article 21.5 Panel found that Brazil's argument under item (k) constituted an alleged "affirmative defence" for which Brazil bore the burden of proof.[74] Brazil appeals this finding.[75]

66. We recall that, before the original panel in *Brazil – Aircraft*, Brazil conceded that it had the burden of proof in demonstrating its alleged "defence" under item (k).[76] However, in these Article 21.5 proceedings, Brazil argues that this burden of proof, under item (k), is on Canada.[77] In our view, the fact that the measure at issue was "taken to comply" with the "recommendations and rulings" of the DSB does not alter the allocation of the burden of proving Brazil's "defence" under item (k). In this respect, we note that Brazil concedes that the revised PROEX measure is, in principle, prohibited under Article 3.1(a) of the *SCM Agreement*; yet Brazil asserts nonetheless that the PROEX measure is justified, under the first paragraph of item (k). Thus, in our view, Brazil is, clearly, using item (k) to make an affirmative claim in its defence. In *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, we said: "It is only reasonable that the burden of establishing [an affirmative] defence should rest on the party asserting it."[78] As it is Brazil that is asserting this "defence" using item (k) in these proceedings, we agree with the Article 21.5 Panel that Brazil has the burden of proving that the revised PROEX is justified under the first paragraph of item (k), including the burden of proving that payments under the revised PROEX are *not* "used to secure a material advantage in the field of export credit terms."

67. To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove *either*: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" we identified in the original dispute as an "appropriate"[79] basis for comparison; *or*, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark".

68. Brazil does not argue that the net interest rates under the revised PROEX are at or above the relevant CIRR. Indeed, Brazil does not contest that the net interest rates under the revised PROEX are

---

[74]Article 21.5 Panel Report, para. 6.22.

[75]Brazil's appellant's submission, paras. 60-61. Brazil's arguments are summarized, *supra*, at para. 19.

[76]Original panel report, *Brazil – Aircraft*, *supra*, footnote 2, para. 7.17.

[77]Brazil's appellant's submission, paras. 60-61.

[78]WT/DS33/AB/R, adopted 23 May 1997, p. 16.

[79]Appellate Body Report, *Brazil – Aircraft*, *supra*, footnote 2, para. 181.

normally *below* the relevant CIRR.[80] Instead, Brazil argues that there is an alternative "market benchmark" that is "appropriate", and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark". In Resolution 2667, Brazil identifies the United States Treasury Bond rate plus 20 basis points (0.2 per cent) as the "appropriate" "market benchmark".[81] Before the Article 21.5 Panel, Brazil argued that the enactment of Resolution 2667:

> … means, effectively . . . that no application for PROEX interest equalization support for regional aircraft will be favorably considered unless it reflects a net interest rate to the borrower equal to or more than the 10-year United States Treasury Bond ("T-Bill") plus 0.2 per cent per annum.[82]

Brazil contends, on this basis, that the revised PROEX is *not* "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k) of the Illustrative List.

69. To prove this argument, Brazil must establish *both* of two elements: first, Brazil must prove that it has identified an appropriate "market benchmark"; and, second, Brazil must prove that the net interest rates under the revised PROEX are at or above that benchmark.

70. We consider, first, whether Brazil has established an appropriate "market benchmark", other than the CIRR. In an effort to do so, before the Article 21.5 Panel, Brazil submitted evidence relating to two examples.

71. As its first example, Brazil submitted documentation relating to the terms of an export financing transaction, at a floating interest rate, for large civil aircraft supported by an export credit guarantee from the Export-Import Bank of the United States. Brazil argued before the Article 21.5 Panel that the interest rate for this transaction[83], plus an amount to reflect a one-time guarantee fee Brazil estimated would have been charged by the lender, should be compared to the "minimum" net interest rate for export credits benefiting from payments under the revised PROEX, that is, the 10-year United States Treasury Bond rate plus 20 basis points (or 0.2 per cent). In Brazil's view, the "minimum" net interest rate for PROEX-supported export credits is higher than the net interest rate of

[80]Response of Brazil to Question 1 of the Article 21.5 Panel (Article 21.5 Panel Report, p. 133). We note that on 12 July 2000, the CIRR for export credit transactions of greater than eight and one half years involving U.S. dollars was 7.69 per cent, whereas the 10-year United States Treasury Bond rate plus 20 basis points was 6.29 per cent.

[81]Article 21.5 Panel Report, para. 6.19.

[82]Brazil's first submission to the Article 21.5 Panel, para. 6 (Article 21.5 Panel Report, p. 102).

[83]LIBOR plus 3 basis points, or 0.03 per cent

that particular Export-Import Bank transaction.[84] In addition, as its second example, Brazil argued that Canada, through the Canadian Export Development Corporation (the "EDC"), has provided export credits for regional aircraft at rates which are below the relevant CIRR.[85]

72. Brazil submitted to the Article 21.5 Panel that, given these two examples, Brazil should also be entitled to support export credits at net interest rates below CIRR, in particular the 10-year United States Treasury Bond rate plus 20 basis points. In this appeal, Brazil contends that the Article 21.5 Panel erred in finding that the evidence of these two examples did not establish an appropriate "market benchmark" for the revised PROEX. It becomes incumbent upon us, therefore, to examine both these examples cited by Brazil.

73. With regard to the first example – the guarantee contract concluded with the Export-Import Bank of the United States – we note that Brazil has presented evidence relating to one actual export credit transaction of this kind. On the basis of this *single* transaction, Brazil attempted to establish a *generalized* "market benchmark", applicable to *all* export credit transactions, this benchmark being the 10-year United States Treasury Bond rate plus 20 basis points. We note that the terms and conditions of export credit transactions in the marketplace vary considerably, depending on the circumstances of a particular export credit transaction, such as the product involved[86], the size or volume of the transaction, the type of export credit practice, the duration of the repayment term, the type of interest rate (fixed or floating) used, and when the transaction is concluded. In our view, Brazil has not demonstrated that the evidence it submitted, relating to a *single* Export-Import Bank export credit transaction, is sufficient, on its own, to justify the *generalized* "market benchmark" relied on by Brazil in *all* transactions relating to regional aircraft under the revised PROEX.

74. In addition, we also note that there would, in any event, be other difficulties in relying on the Export-Import Bank transaction to establish a "market benchmark" for PROEX. As we have noted, the terms and conditions of export credit transactions in the marketplace vary considerably. In identifying an "appropriate" "market benchmark" below the CIRR, a WTO Member must show that the "benchmark" on which it relies is based on evidence from relevant, comparable transactions in the marketplace. In this respect, we observe that the Export-Import Bank transaction relates to *large civil aircraft*, whereas PROEX payments involve *regional jet aircraft*. Further, the Export-Import Bank transaction involves *floating* interest rate financing, whereas PROEX involves *fixed* interest rate financing. Finally, the Export-Import Bank transaction involves a government *loan guarantee*,

[84]Article 21.5 Panel Report, para. 6.94.

[85]*Ibid*., para. 6.97; see Response of Canada to Question 4(a) of the Article 21.5 Panel (Article 21.5 Panel Report, p. 82).

[86]We note that, in these proceedings, we are dealing with regional aircraft. Of course, item (k) applies in the context of export credit transactions involving other goods.

rather than the *interest rate equalization payments* made under PROEX.[87] We, therefore, have reservations – on which we need not opine – as to the relevance of the Export-Import Bank transaction, relied upon by Brazil, in attempting to establish a "market benchmark" for PROEX.

75. With respect to the second example – Brazil's assertions relating to EDC financing at below the relevant CIRR – we note that Canada has admitted that EDC financing has sometimes been offered at some, unspecified, interest rate below the relevant CIRR.[88] However, Brazil has provided *no evidence* of any specific transaction in which the EDC has offered financing at rates below the relevant CIRR, nor has Brazil offered any evidence of the specific rate actually offered by the EDC in these transactions. In our view, the admission by Canada that EDC has offered, in certain transactions, an unspecified interest rate *somewhere* below the applicable CIRR does not, in any way, identify an alternative *generalized* "market benchmark" below the CIRR. In short, Canada's admission does not explain why the specific interest rate chosen for the revised PROEX – the United States Treasury Bond 10-year rate, plus 20 basis points (or 0.2 per cent) – should be seen as an appropriate "market benchmark".

76. We, therefore, find that Brazil has not established an appropriate "market benchmark" for the revised PROEX under the "material advantage" clause of the first paragraph of item (k) of the Illustrative List. We said Brazil had to prove *both* that it had identified an appropriate "market benchmark" below the CIRR and that its net interest rates under the revised PROEX are at or above that benchmark.[89] As Brazil has not identified an "appropriate" "market benchmark" below the CIRR, it is not possible to determine whether the net interest rates under the revised PROEX are at or above such a "market benchmark".

77. For these reasons, we agree with the Article 21.5 Panel's conclusion that "Brazil has failed to demonstrate that PROEX payments are not 'used to secure a material advantage in the field of export credit terms' within the meaning of the first paragraph of item (k)" of the Illustrative List.[90]

---

[87]We recall that it is not necessary for us to decide, in this case, whether transactions involving government loan guarantees can provide an appropriate "market benchmark", below the CIRR, to determine whether a "payment", under item (k), is "used to secure a material advantage in the field of export credit terms." (*Supra*, para. 64, footnote 73).

[88]Canada concedes that there were "instances where certain of EDC's financing transactions were at a rate less than the CIRR applicable on the date the transaction closed." However, Canada claims that with the exception of one Canada Account transaction, the interest rate charged in respect of regional aircraft has been "market-based". According to Canada, this is because the CIRR "lags" behind the market due to the fact that the CIRR is set once a month whereas market rates fluctuate more regularly. (See Response of Canada to Question 4(a) of the Article 21.5 Panel (Article 21.5 Panel Report, pp. 82-83).)

[89]See, *supra*, para 69.

[90]Article 21.5 Panel Report, para. 6.106.

C. *Are export subsidies under PROEX "payments" within the meaning of the first paragraph of item (k)*?

78. Brazil also appeals the Article 21.5 Panel's finding that export subsidies under the revised PROEX are not "payments" within the meaning of the first paragraph of item (k). We have found that Brazil has failed to establish that export subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k). As we noted earlier, in order to establish a justification under item (k), Brazil was required to prove each of the three issues it argued before the Article 21.5 Panel.[91] As Brazil has failed to prove one of the elements necessary to prove that payments made under the revised PROEX are justified by item (k), we do not believe it is necessary to examine the issue of whether export subsidies under the revised PROEX are "the payment [by governments] of all or part of the costs incurred by exporters or financial institutions in obtaining credits" within the meaning of the first paragraph of item (k). Therefore, we do not address the Article 21.5 Panel's findings[92] on this issue. These findings of the Article 21.5 Panel are moot, and, thus, of no legal effect.

D. *May the first paragraph of item (k) be interpreted to establish that an export subsidy is "permitted"*?

79. Brazil also appeals the Article 21.5 Panel's finding that "the first paragraph of item (k) cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is 'permitted".[93]

80. If Brazil had demonstrated that the payments made under the revised PROEX were not "used to secure a material advantage in the field of export credit terms", and that such payments were "payments" by Brazil of "all or part of the costs incurred by exporters or financial institutions in obtaining credits", then we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List. However, Brazil has not demonstrated that those conditions of item (k) are met in this case. In making this observation, we wish to emphasize that we are not interpreting footnote 5 of the *SCM Agreement*, and we do not opine on the scope of footnote 5, or on the meaning of any other items in the Illustrative List.

[91]See, *supra*, para. 58.

[92]Article 21.5 Panel Report, para. 6.72.

[93]*Ibid*., para. 6.67. See also, Article 21.5 Panel Report, para. 6.106(ii).

81. However, we do not believe it is necessary for us to rule on these general questions in order to resolve this dispute. We, therefore, hold that the Article 21.5 Panel's finding that "the first paragraph of item (k) cannot be used to establish that a subsidy which is contingent upon export performance within the meaning of Article 3.1(a) is 'permitted'"[94] is moot, and, thus, is of no legal effect.

VII. Findings and Conclusions

82. For the reasons set out in this Report, the Appellate Body:

(a) upholds the conclusion of the Article 21.5 Panel that as a result of the continued issuance by Brazil of NTN-I bonds, after 18 November 1999, pursuant to letters of commitment issued before 18 November 1999, Brazil has failed to implement the recommendation of the DSB that it withdraw the prohibited export subsidies under PROEX within 90 days; and

(b) upholds the Article 21.5 Panel's findings that payments made under the revised PROEX are prohibited by Article 3 of the *SCM Agreement*, and are not justified under item (k) of the Illustrative List, and therefore upholds the Article 21.5 Panel's conclusion that Brazil has failed to implement the recommendation of the DSB that it withdraw the export subsidies for regional aircraft under PROEX within 90 days.

[94]Article 21.5 Panel Report, para. 6.67. See also, Article 21.5 Panel Report, para. 6.106(ii).

Signed in the original at Geneva this 12th day of July 2000 by:

_____

James Bacchus
Presiding Member

_____ _____

Claus-Dieter Ehlermann
Member

Julio Lacarte-Muró
Member