ANNEX A

Submissions of Brazil

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ANNEX A-1

RESPONSE OF BRAZIL TO COMMUNICATION OF 16 MAY 2001 FROM CANADA TO BRAZIL

(21 May 2001)

In a letter to the Panel dated 16 May 2001, Canada requested that Brazil provide

ANNEX A-2

COMMUNICATION OF 21 MAY 2001 FROM BRAZIL TO THE PANEL

(21 May 2001)

1. With this letter, Brazil requests that the Panel exercise its discretion, under Article 13.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), to request from Canada documents and other information concerning the terms of any support from 1 January 1995 onward committed or granted by the Export Development Corporation ("EDC"), Canada Account, Investissement Québec ("IQ"), or any subsidiary organizations thereof, in connection with the sale of regional aircraft by Bombardier, the Canadian manufacturer. As you are aware from its request for establishment of this Panel, Brazil considers that Canadian support for its regional aircraft industry under these programs, each of which was challenged in *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*")[1], constitutes prohibited export subsidies. A recent transaction involving Air Wisconsin, discussed below, is but one example of this support.

2. This request is necessitated by Canada's refusal to produce evidence that is solely within its possession, and that is necessary to the Panel's assessment of this dispute. Later in this letter, Brazil will present evidence available from public sources establishing a *prima facie* case that Canada Account support for the Air Wisconsin transaction, and EDC and IQ support for the Canadian regional aircraft industry, constitutes a prohibited export subsidy. In subsequent submissions, Brazil will provide additional evidence supporting its claims, both with respect to the Air Wisconsin transaction and other deals. However, given the confidential nature of regional aircraft transactions[2], the only direct evidence available – documents concerning the terms of Canadian government support for regional aircraft transactions – is in the sole possession of the Canadian government.

Canada's refusal to produce information

3. Canada's repeated failure to provide highly relevant evidence within its sole possession is well-documented. In the *Canada – Aircraft* dispute, Canada refused, in consultations with Brazil, to provide documentary information regarding support under the very same programs at issue in this dispute.[3] Moreover, the Report of the Panel in that dispute includes 26 citations to Canada's refusal to provide specific documentary information requested not by Brazil, but w (Affepn6 -selreoth with resphis) Tj 0 -12.75

of EDC, Canada Account and IQ support for Canadian regional aircraft industry transactions.[5] Other than a statement that support for one transaction – the Air Wisconsin deal – would "probably" be through the Canada Account, Canadian representatives at the consultations refused to produce any such information.[6]

5. Canada's failure to provide this information to Brazil during consultations is directly contrary to its legal obligations. Tribunals in a variety of public international law fora have long recognised that governments party to international disputes have a particular responsibility to provide documents within their exclusive control.[7] Indeed, in *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India – Pharmaceuticals*"), the Appellate Body specifically recognised that all Members are required to be "fully forthcoming" at all stages of WTO dispute settlement proceedings, noting that:

> All parties engaged in dispute settlement under the DSU must be fully forthcoming

these legal standards, Brazil first presents evidence establishing that support under the Canada Account for one recent transaction – Air Wisconsin – constitutes a prohibited export subsidy. As noted above, this is only one example of a transaction supported by EDC, the Canada Account or IQ. Second, Brazil presents evidence regarding support *via* the EDC. Third, Brazil presents evidence with respect to IQ support.

Prima facie case with respect to Canada Account

11. Canada Account support for the Air Wisconsin transaction constitutes a prohibited export subsidy. On 10 January 2001, Canadian Minister of Industry Brian Tobin, along with Canadian Minister for International Trade Pierre Pettigrew, announced government support for the sale to Air Wisconsin of 75 Bombardier regional jets, with an option for the purchase of 75 more. While details of the Canadian government support were not provided, Rod Giles, a spokesman for EDC, noted that "[t]his transaction will be done under the [EDC's] Canada account, which is used in those instances where [the business deal] is deemed to be in the national interest."[16] A "backgrounder" regarding the Canada Account, which is administered by the EDC, was attached to the Industry Canada news release accompanying the Ministers' announcement.[17]

12. Minister Tobin characterized the support Canada was making available to Air Wisconsin as a loan or direct financing at a rate equal to that allegedly offered by Brazil for Bombardier rival Embraer's offer to Air Wisconsin.[18] Specifically, Minister Tobin stated that Canada was matching support allegedly offered by Brazil to help Embraer secure the sale.[19] According to Minister Tobin, the support allegedly offered by Brazil was itself a subsidy, granted at below-market rates.[20] Thus,

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[16] "Bombardier Snags $2.4 B order from U.S. airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001 (Exhibit Bra-2).

[17] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 (Exhibit Bra-3).

[18] "Canadian government lends $1.7 billion to Bombardier," *Canadian Machinery and Metalworking*, 11 January 2001 ("The Canadian government will lend $1.7 billion in *direct financing* to support Bombardier Inc.'s fight against heavily (and illegally) subsidized Brazilian aircraft manufacturer Embraer SA, says newly appointed Industry Minister Brian Tobin.") (emphasis added) (Exhibit Bra-4); "Ottawa backs Bombardier," *PoliticX*, 11 January 2001 ("Industry Minister Brian Tobin yesterday announced Ottawa would *lend* about $1.7 billion to a U.S. airline to buy 75 Bombardier regional jets. He said the *loan* to Air Wisconsin Airlines Corp. is necessary to match dollar-for-dollar subsidies the Brazilian government has made to its aerospace company, Empresa Brasileira de Aeronautica SA.") (emphasis added) (Exhibit Bra-5).

[19] "Canada to aid Bombardier in jet deal: Tobin vows to protect jobs in subsidy battle with Brazil", *Ottawa Citizen*, 11 January 2001 ("The subsidy, which comes from the cabinet-controlled Canada Account, will attempt to match the terms of a state-supported bid by Brazil's Embraer for the Air Wisconsin contract, Mr. Tobin said.") (Exhibit Bra-6); "Canada to match illegal Brazilian aerospace subsidies to save market share," *Ottawa Citizen*, 11 January 2001 ("'We're doing something which matches a program which has been judged illegal by the WTO [World Trade Organization],'" Industry Minister Brian Tobin said Wednesday in announcing the cabinet decision" to "match illegal Brazilian trade subsidies and loan an estimated $1.5 billion at below market rates to an American buyer of Bombardier aircraft.") (Exhibit Bra-7); "Ottawa backs Bombardier," *PoliticX*, 11 January 2001 ("Industry Minister Brian Tobin yesterday announced Ottawa would lend about $1.7 billion to a U.S. airline to buy 75 Bombardier regional jets. He said the loan to Air Wisconsin Airlines Corp. is necessary to match dollar-for-dollar subsidies the Brazilian government has made to its aerospace company, Empresa Brasileira de Aeronautica SA.") (emphasis added) (Exhibit Bra-5); "Ottawa Backs

anything "matching" that rate is by definition also a subsidy. In fact, Minister Tobin characterized the support offered by Canada itself in those very terms: "'What we're doing is using the borrowing strength and capacity of the government to give a better rate of interest.'"[21]

13. The $2.35 billion Air Wisconsin deal was confirmed by Bombardier on 16 April 2001, with International Trade Ministry spokesman Sebastien Theberge stating that "the deal is in essence the one announced (by Mr. Tobin)".[22]

14. Support by the Canada Account, which according to Canadian officials is the source of Canadian government support for the Air Wisconsin transaction, was found by the Panel in *Canada* –

16. With respect to "financial contribution", EDC's website confirms that Canada Account provides "insurance coverage, financing and guarantees" [25], each of which constitutes either a "direct transfer of funds" or a "potential direct transfer of funds or liabilities", under Article 1.1(a)(1)(i) to the SCM Agreement. Moreover, as noted above, Minister Tobin stated that Canadian support for the Air Wisconsin transaction would take the form of a loan or direct financing, which constitute "direct transfer[s] of funds".

17. With respect to "benefit", Minister Tobin acknowledges, as noted above, that Canada is matching what he characterized as subsidized support from Brazil to Air Wisconsin. Brazil recalls the Appellate Body's determination that a benefit arises when a financial contribution confers "terms more favourable than those available to the recipient in the market".[26] Any Canadian support "matching" terms more favourable than those available to Air Wisconsin in the market is, by definition, itself on similarly more favourable terms than those available to Air Wisconsin in the market. Moreover, the Minister stated that Canada was in this instance "using the borrowing strength and capacity of the government to give a better rate of interest."[27] Both of these statements, as well as others noted above, satisfy the Appellate Body's "benefit" standard.

18. Finally, with respect to export contingency, EDC's website confirms that "[t]he Canada Account is used to support export transactions . . ".[28] Similarly, the Canada Account "backgrounder" accompanying Industry Canada's announcement of its support for the Air Wisconsin deal states that Canada Account is one way for EDC to satisfy its "mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities".[29]

19. Thus, while the Appellate Body has held that setting forth a *prima facie* case is not a prerequisite to a request for information under DSU Article 13.1, Brazil has, with this evidence, established a *prima facie* case that Canada Account support for the Air Wisconsin transaction constitutes a prohibited export subsidy. As noted above, in its submissions to this Panel, Brazil will provide further information from publicly-available sources regarding other examples of EDC, Canada Account and IQ support for the Canadian regional aircraft industry. Direct evidence of this support, however, is solely within Canada's possession.

Prima facie case with respect to EDC

20. Canada itself, in proceedings considering the consistency of the Brazilian PROEX programME with the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), acknowledged that EDC provides support to the Canadian regional aircraft industry on terms below the commercial interest reference rates ("CIRR") established by the OECD's *Arrangement on suieresn CSms belllf, in proceedi4 Tc 2.5427 Tw (e Canadil12.75 raft indi/F0 65s37 capacit79nada Acc*

21. The Appellate Body stated, in its Report in *Brazil – Aircraft*, that a net interest rate "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,'" within the meaning of item (k) to Annex I of the SCM Agreement.[31] The Appellate Body also noted in that case that the term "benefit", within the meaning of Article 1.1(b) of the SCM Agreement, is different from the term "material advantage" in item (k), and that item (k) and "material advantage" become an issue only after support has been deemed to confer a benefit and constitute a subsidy. In other words, export support that confers a material advantage will always confer a benefit, but export support that confers a benefit will not always secure a material advantage.[32]

22. Because Canada has acknowledged that EDC has lent at rates [], it has also provided, in the Appellate Body's words, "a positive indication" that EDC not only secures a material advantage, but also confers a benefit.

23. With respect to export contingency, Article 10(1) of the Export Development Act states that EDC was founded "for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[33] As such, EDC support for the Canadian regional aircraft industry is contingent in law or in fact on export, within the meaning of Article 3.1(a) of the SCM Agreement.

24. Once again, while setting forth a *prima facie* case is not a prerequisite to an Article 13.1 request for information, the evidence provided above in fact establishes that EDC support for the Canadian regional aircraft industry constitutes a prohibited export subsidy.

Prima facie case with respect to IQ

25. Along with federal aid, the Air Wisconsin transaction also benefited from IQ support, as part of a $226 million loan guarantee package recently made available to purchasers of Bombardier aircraft.[34] According to IQ spokesman Jean Cyr:

by Canada itself when, in *Brazil – Aircraft*, it described the beneficial effect of a loan guarantee in the following terms:

> The transaction cited by Brazil is a simple US Ex-Im Bank loan guarantee under which the Government of the United States extends its own sovereign credit risk to cover a percentage of the amount financed. In such circumstances, the lending bank establishes financing terms in the light of the risk of the US Government, not the borrower.[36]

Thus, provision of a guarantee and substitution of a government's credit rating for that of the borrower confers a benefit.

27. With respect to export contingency, Article 25 of the Act Respecting Investissement-Québec and Garantie-Québec states that as part of its mission, IQ is directed to facilitate "export activities".[37] Similarly, paragraph 1 of Quebec Decree 572-2000 enables IQ to offer financial support to encourage companies, *inter alia*, to undertake export projects, including, under paragraph 2, the sale of goods outside of Quebec.[38] Moreover, paragraph 2 to Quebec Decree 841-2000 requires IQ to limit its financial support to, among other things, "market development" projects[39], which under paragraph 3 include the growth of export sales and the sale of goods outside of Quebec.[40] Paragraph 10 to Annex II of Decree 841-2000 provides additional information about the "market development" projects that can receive IQ support, *e.g.*, the promotion of exports in existing markets, the creation of export consortiums, and the extension of export credit margins.[41]

28. During consultations, Brazil asked Canada for details concerning IQ and its activities. Canada's representatives stated that they had no information concerning IQ, did not bring any official capable of discussing IQ to the consultations, and were therefore not prepared to discuss it. The Member whose actions are the subject of consultations has an obligation, under Article 4.2 of the DSU, to accord sympathetic consideration to the requests of other Members. In the absence of any information provided by Canada, the evidence set forth herein is sufficient to establish a *prima facie* case that IQ support constitutes a prohibited export subsidy.

Documents and information to be requested

29. To facilitate an objective assessment of the matter before it, *i.e.*, whether EDC, Canada Account and IQ provide prohibited export subsidies to support sales by the Canadian regional aircraft industry, Brazil considers that the Panel would need to request, at a minimum, documents providing the following transaction-specific information for the period 1 January 1995 to the present:

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[36] WT/DS46/RW, Annex 1-2, para. 36.

[37] Act Respecting Investissement-Québec and Garantie-Québec (Exhibit Bra-18).

[38] Décret 572-2000, 9 mai 2000, Concernant le programme du Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi, para. 1 ("1. Le prent programme vise à permettre à Investissement-Québec, dans le cadre de la réalisation de sa mission, d'apporter son soutien financier afin d'inciter les entrepreises à réaliser des projets d'investissement et d'exportation et de favoriser l'émergence de nouveaux projets . . .") (Exhibit Bra-19). *See also Id*. at para. 2 ("'exportation': toute activité ayant pour objet: - la vente de biens, la prestation de services et l'exécution de contrats à l'extérieur de Québec.").

[39] Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises, para. 2 ("L'aide financière accordée en vertu du présent programme doit avoir pour objet . . . . de développement de marchés . . .) (Exhibit Bra-20).

[40] *Id*. at para. 3 ("'Développement de marchés: . . . – la commercialisation . . . pour l'accroissement de ventes . . . à l'extérieur du Québec; - la vente de biens . . . à l'extérieur du Québec; - la formation d'un groupement d'entreprises à des fins de vente de biens . . . à l'extérieur du Québec . . . .").

[41] *Id*. at Annex II, para. 10 (10. Développement de marchés: . . . – la promotion des exportations sur un marché existant; . . . – la formation de consortium d'exportation; . . . – la marge de crédit à l'exportation . . .).

? Type of support (*e.g.*, loan, loan guarantee, equity guarantee, equity support, etc.)
? Base interest rate provided to recipient (for direct transfers of funds) or secured by recipient (for potential direct transfers of funds)
? Risk spread added onto the base interest rate
? Fee and/or premium charged
? Tenor of support
? Credit rating of recipient
? Date of transaction
? Value of transaction (in the currency of the transaction)
? Value of EDC/Canada Account/IQ support for transaction (in the currency of the transaction)
? Cash payment requirements for transaction
? Spare parts coverage of EDC/Canada Account/IQ support
? Any conditions attached to award or receipt of the support

Conclusion

30. For the foregoing reasons, Brazil requests that the Panel immediately exercise its discretion to request from Canada documents concerning EDC, Canada Account and IQ support for Canadian regional aircraft transactions from 1 January 1995 onward, including but not limited to the Air Wisconsin deal. This confidential information is not available from public sources, and Canada's failure to produce it, both in the previous *Canada – Aircraft* dispute and thusfar in these proceedings, is well-documented. A request by the Panel that Canada produce this documentary information, pursuant to DSU Article 13.1, is "necessary and appropriate" to enable the Panel to discharge its duty to make "an objective assessment of the matter before it," pursuant to Article 11 of the DSU.

Exhibit List

Brazilian consultation questions to Canada	Exhibit Bra-1
"Bombardier Snags $2.4 B order from U.S. airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001	Exhibit Bra-2

"Bombardier cranks up job mill after signing $2.35-billion jet deal: Federal subsidy gives U.S. airline below-market rate," *Ottawa Citizen*, 17 April 2001	Exhibit Bra-14
"Bombardier signs contract with Air Wisconsin for up to 150 CRJ200 regional jets," *Bombardier Press Release*, 16 April 2001	Exhibit Bra-15
EDC website, "How We Work"	Exhibit Bra-16
Export Development Act	Exhibit Bra-17
Act Respecting Investissement-Québec and Garantie-Québec	Exhibit Bra-18
Décret 572-2000, 9 mai 2000, Concernant le programme du Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi	Exhibit Bra-19
Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises	Exhibit Bra-20

ANNEX A-3

FIRST WRITTEN SUBMISSION OF BRAZIL

Volume 1 of 4 (Narrative Submission)

(30 May 2001)

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(Exhibits Bra-1 – Bra-20 are included with Brazil's 21 May 2001 letter to the Panel)

Brazilian consultation questions to Canada	Exhibit Bra-1
"Bombardier Snags $2.4 B order from US airline: Air Wisconsin: Government helps out with low-cost loan," *The National Post*, 17 April 2001	Exhibit Bra-2
"Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs,"	

CRJ200 regional jets," *Bombardier Press Release*, 16 April 2001	
EDC website, "How We Work"	Exhibit Bra-16
Export Development Act	Exhibit Bra-17
Act Respecting Investissement-Québec and Garantie-Québec	Exhibit Bra-18
Décret 572-2000, 9 mai 2000, Concernant le programme du Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi	Exhibit Bra-19
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I. INTRODUCTION

1. On 10 January 2001, Canada's Minister of Industry, Mr. Brian Tobin, announced that Canada would provide export credits that were contrary to Canada's obligations under the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement" or "Agreement") to assist the United States regional carrier Air Wisconsin in its acquisition of 75 jet aircraft, with an option for an additional 75, from the Canadian producer Bombardier.[1] The news release accompanying Minister Tobin's press conference described Canada's Export Development Corporation ("EDC") and the Canada Account as sources of the subsidy.[2] In his press conference, Minister Tobin also mentioned assistance from the Province of Quebec.[3]

2. On 22 January 2001, on the basis of Minister Tobin's statement and other information it had obtained, Brazil requested consultations with Canada. Brazil acted on the belief that export credits, within the meaning of item (k) of Annex I to the SCM Agreement, were being provided to support sales by the Canadian regional aircraft industry by Canada's EDC and the Canada Account, and that loan guarantees, within the meaning of item (j) of Annex I to the Agreement, were being provided to that industry by the Province of Quebec through its agency, Investissement Quebec ("IQ"). Brazil considered that all of these measures were subsidies, within the meaning of Article 1 of the Agreement, and that they were contingent, in law or in fact, upon export, within the meaning of Article 3 of the Agreement.

3. Consultations were held in Geneva on 21 February 2001. Canada's representatives at the consultations were unable or unwilling to specify whether assistance to Canada's regional aircraft industry would be provided by the Canada Account or EDC or both, or to provide any details beyond those given by Minister Tobin. They also stated that they were not familiar with IQ and were therefore unable to respond to any of Brazil's questions concerning IQ.

4. With Canada declining to provide any information at consultations concerning EDC, Canada Account, or IQ generally, or the Air Wisconsin transaction specifically, Brazil concluded that Canada had not provided the "sympathetic consideration" mandated by Article 4.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("Dispute Settlement Understanding" or "DSU"), and that the dispute could not be settled through consultations.

5. On 1 March 2001, Brazil requested the establishment of a panel pursuant to Article XXIII of the GATT 1994, Article 6 of the DSU, and Article 4.4 of the SCM Agreement. Brazil requested that the panel consider and find that:

1. Export credits, including financing, loan guarantees, or interest rate support by or through the Canada Account are and continue to be prohibited export subsidies within the meaning of Articles 1 and 3 of the Agreement.

2. Canada has not implemented the report of the Article 21.5 Panel, adopted by the DSB, requesting that Canada withdraw Canada Account subsidies.

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[1] Transcript of Press Conference of Industry Minister Brian Tobin, 10 January 2001, para. 7 ("Tobin Press Conference") (Exhibit Bra-21). The transcript was made from a recording of the press conference made by the Canadian Parliamentary Press Gallery, a group of journalists accredited to cover Canadian Government and Parliament and granted space in the Parliament buildings.

[2] "Canada Ready to match Brazilian Financing Terms to Preserve Aerospace Jobs," *Industry Canada News Release*, 10 January 2001 (Exhibit Bra-3).

[3] Tobin Press Conference, para. 7 (Exhibit Bra-21).

Canada continues to utilize a programme previously found to be a violation of its commitments under the SCM Agreement; (2) with regard to another of the measures – export assistance through EDC – additional information and further developments have led Brazil to act on the suggestion of the Appellate Body in the previous proceeding that it bring the matter before a Panel again; and (3) with regard to the third measure – export assistance through IQ – Brazil has obtained additional information supporting its claims.

A. CANADA ACCOUNT

9. On 29 August 1999, the DSB adopted the Panel Report, as upheld by the Appellate Body, in "*Canada – Aircraft*". That Report found that Canada Account export credits were subsidies contingent in law upon export performance, and were therefore prohibited by Article 3.1(a) of the SCM Agreement. The DSB recommended that Canada withdraw these subsidies within 90 days.

10. In a Status Report to the DSB on 18 November 1999, Canada stated:

> With respect to Canada Account debt financing for the export of Canadian regional aircraft, which was found to be inconsistent with Canada's obligations under the SCM Agreement, *Canada wishes to inform the DSB that there will be no deliveries of regional aircraft after 18 November 1999 benefiting from such Canada Account financing*. In addition, the Minister for International Trade has approved a policy guideline which requires that all future Canada Account transactions for all sectors, not only those involving the regional aircraft sector, comply with the OECD Arrangement on Guidelines for Officially Supported Export Credits. By this policy, the Minister undertakes not to authorize any transaction under the Canada Account unless it complies with the Arrangement. No Canada Account transaction may proceed without Ministerial authorization.[9]

11. Brazil was of the view that this action was insufficient to implement the ruling and recommendation of the DSB with regard to the Canada Account, and, accordingly, sought review under Article 21.5 of the DSU. The Panel established to examine the matter agreed with Brazil, concluding that "Canada has failed to implement the 20 August 1999 recommendation of the DSB

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B. EXPORT DEVELOPMENT CORPORATION

14. Brazil also challenged EDC in *Canada – Aircraft*. In that proceeding, Brazil was severely hampered by the fact that Canada had not notified the relevant details of its EDC subsidy programme to the WTO, as required by Article 25 of the SCM Agreement. The Panel, accordingly, requested specific information from Canada, information that Canada refused to provide.[12] While the Panel stated that it "regret[ted] deeply Canada's refusal to provide the requested information,"[13] the Panel concluded that without the information requested from Canada, Brazil had not presented a *prima facie* case, and therefore found in favour of Canada.[14]

15. Brazil appealed, arguing that the Panel erred in law in not drawing inferences adverse to Canada from its refusal to provide information requested by the Panel itself. In an opinion that made clear the responsibility of parties to provide information to Panels, the Appellate Body also made clear the specific authority of Panels to draw appropriate inferences from the failure of parties to provide requested information.[15] The Appellate Body went on to state that, had it "been deciding the issue that confronted the Panel, we might well have concluded that the facts of record did warrant that the information Canada withheld" called for an inference adverse to Canada.[16] However, the Appellate Body concluded that, while it might have decided the question differently, the Panel had not erred in law or abused its discretion.[17]

16. In declining Brazil's appeal, the Appellate Body made a highly unusual – if not unprecedented – suggestion that Brazil bring the same case before a Panel again. "By this finding," the Appellate Body said, "we do not intend to suggest that Brazil is precluded from pursuing another dispute settlement complaint against Canada, under the provisions of the *SCM Agreement* and the DSU, concerning the consistency of certain of the EDC's financing measures with the provisions of the *SCM Agreement.*"[18] The Appellate Body even suggested an alternative proceeding in the Committee on Subsidies and Countervailing Measures that Brazil might consider.[19]

17. Brazil did not act upon the Appellate Body's suggestion when it was made because the parties had been actively involved in negotiations since August 1999, in an attempt to resolve their differences. These negotiations, however, have not been successful, and, in light of subsequent

SCM Agreement

extended discussion by the Appellate Body in paragraphs 181 through 206 of its Report in *Canada – Aircraft*, draw the appropriate adverse inferences.

C. INVESTISSEMENT QUÉBEC

19. With regard to IQ, the earlier Panel also concluded that Brazil had not adduced sufficient evidence to establish a *prima facie* case.[20] In that proceeding as well, Brazil was hampered by the lack of transparency in Canada's programmes. Brazil pointed to the November 1998 Trade Policy Review of Canada as evidence of subsidies provided by IQ, noting that it did so by "provid[ing] export guarantees for projects considered too risky for private financial institutions."[21] However, the Panel concluded that the Trade Policy Review is not "'intended to serve as a basis for the enforcement of specific obligations under the Agreements or for dispute settlement procedures'" and therefore declined to consider that evidence.[22]

20. As it did with regard to other programmes, in *Canada – Aircraft* Canada refused to provide information requested by the Panel regarding IQ.[23] In this proceeding, Brazil continues to hampered by the lack of transparency in the programme, and IQ therefore is included in Brazil's 21 May request to the Panel. Nevertheless, Brazil has been able to obtain some additional information concerning IQ, and provides that information to the Panel in this submission.

III. EXPORT DEVELOPMENT CORPORATION ("EDC")

A. EDC WAS ESTABLISHED TO PROVIDE FINANCIAL SERVICES TO CANADIAN EXPORTERS ON MORE FAVOURABLE TERMS THAN THEY COULD OBTAIN IN THE MARKET

21. EDC was established in 1969 "for the purposes of supporting and developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[24] Its status as a Crown corporation allows it three important privileges:

1. It does not have to pay income tax;
2. It does not have to pay dividends;
3. It can borrow on the credit of the Government of Canada.[25]

22. EDC, in its own words, "is volume-driven, as opposed to other financial institutions that are profit-driven."[26] "If EDC were to be privatized," the Corporation points out, "its corporate focus would shift to maximizing profit, rather than maximizing exports. Thus, as a private entity, in order to return the maximum profit to its shareholders, EDC would no longer be able to serve the market segments that are already not well served by commercial lenders and insurers. … EDC, as a Crown corporation, services Canadians in a manner that other institutions do not."[27]

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[20] WT/DS70/R, para. 9.275.
[21] WT/DS70/R, para. 9.274.
[22] *Id*.
[23] WT/DS70/R, para. 9.272.
[24] Export Development Act, Section 10(1) (Exhibit Bra-17); EDC 2000 Annual Report, pg. 47 (Exhibit Bra-22).
[25] EXPORT DEVELOPMENT CORPORATION 1999-2000 REFERENCE GUIDE, pg. 9 ("EDC Reference Guide") (Exhibit Bra-23).
[26] *Id*., pg. 10.
[27] *Id*., pg. 26.

23. EDC repeatedly makes clear that, in maximizing exports rather than profits, its object and purpose is to provide financial services to Canadian exporters on terms more favourable than those that exporters can obtain in the market:

- "Canadian firms' ability to access capital for international sales and investments has been limited. Many Canadian companies simply lack the financial strength to mobilize debt and investment financing to the same degree as their more highly capitalized rivals."[28]

- "International trade is risky, and it requires financial capacity that is often lacking because of those risks. EDC was created to help companies manage those risks and to increase the international finance capacity available to Canadian companies. By enhancing Canada's export capacity, EDC helps companies create and maintain employment and generate profits."[29]

- "EDC has demonstrated its appetite for international risk repeatedly in the past, including during the Asian crisis of 1997, which prompted many private financial intermediaries to withdraw from the marketplace. Such episodes underscore the need for a financial institution devoted exclusively to the financial needs of Canadian exporters."[30]

24. EDC, as it admits, raises its capital from the taxpayers of Canada and by borrowing on the sovereign credit of the Government of Canada. "All obligations under debt instruments issued by the Corporation are obligations of Canada."[31] It thus is able to raise funds at rates no market-based institution can match. Then, again by its own admission, unlike a market-based institution, it pays no income tax on any profits it may earn, and its shareholder expects no dividends. These advantages permit EDC to provide to Canadian exporters, including exporters of regional aircraft, financial services that those exporters or their customers would not be able to obtain in the market on equally favourable terms.

25. EDC explicitly acknowledges this role: "EDC complements the banks and other financial intermediaries, but cannot substitute for them."[32] Its "goal is to help absorb the risk on behalf of Canadian exporters, beyond what is possible by other financial intermediaries".[33] EDC, in its own words, attempts to satisfy "the seemingly endless appetite of Canadian exporters for financial support . . . ."[34]

26. The former President of EDC, Mr. Paul Labbé, in testimony before the Canadian Parliament, made clear the gap between EDC and a market-based institution. EDC strives to "mak[e] at least the rate of inflation," he said, recognizing that this is well below the return "that would be required to survive in the private sector."[35] The current President of EDC, Mr. Ian Gillespie, has stated, "The goal for Canada is to make sure that we have a competitive advantage . . . not just a level playing field."[36]

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[28] EDC 2000 Annual Report, pg. 3 (Exhibit Bra-22).

[29] *Id*., pg. 14.

[30] *Id*., pg. 17.

[31] *Id*., pg. 47 (note 1).

[32] EXPORT DEVELOPMENT CORPORATION, 1995 *Chairman and President's Message*, pg. 4 ("EDC Message") (Exhibit Bra-24).

[33] *Id*., pg. 2.

[34] *Id*., pg. 4.

[35] Testimony of EDC Officials, Senate of Canada, 35th Parliament, 1st Sess., Proceedings of the Standing Senate Committee on Banking, Trade and Commerce, Issue No. 48, 28 November 1995, pg. 48:22 (Exhibit Bra-25).

[36] Testimony of EDC President Mr. Ian Gillespie before the Standing Committee on Foreign Affairs and International Trade, 6 November 1997, pg. 15 (Exhibit Bra-26).

The term "market window" is used to describe the provision of financing on terms that are consistent with those that are available in the market place to a particular borrower in a particular transaction. When an export credit agency provides "market window" financing, it is providing financing on terms and conditions consistent with those available from commercial banks and lenders. In that sense, the borrower

> business which is taken as a direct liability of the Government, while the latter includes a much higher percentage of "market window" commercial transactions, where the need to protect confidentiality would be greater, and where the risk of loss remains with the Corporation itself.[47]

34. Similarly, in response to the question, "Why doesn't EDC publicly disclose its transactions?", EDC states:

> EDC operates in much the same manner as a bank or insurance company. It receives a great deal of confidential information from its customers and potential customers and does not disclose this information without their permission.[48]

35. But EDC is not just another bank. It is a government-owned entity whose actions are subject to the SCM Agreement. It possesses advantages no private financial institution possesses: (1) it borrows at the sovereign rate of the Government of Canada; (2) it pays no income taxes; and (3) its shareholder expects no dividends.[49] This permits EDC, whenever it chooses to do so, to offer terms and conditions more favourable than those that can be offered by a market-based financial institution, to obtain "a competitive advantage for Canadian exporters, not just a level playing field."[50] The difference between EDC and a bank is further demonstrated by its customer restriction. A bank would finance any transaction, provided the bank believed it would be profitable. Neither the nationality of the manufacturer nor that of the buyer would matter, nor would the national origin of parts and components in any product financed. EDC, however, supports only Canada's export trade.[51]

36. Former United States Treasury Secretary Lawrence H. Summers has noted that "Market Window institutions *purport* to operate under private sector discipline". "However," he added:

> we believe that Market Window institutions either directly, or potentially, contravene [OECD] Arrangement rules because they are controlled and implicitly subsidized by the state. Thus, *Market Window institutions operate with an unfair competitive advantage* because they benefit from special government concessions including guarantees by the state that enable them to raise funds at a lower cost than their private sector competitors, and because they are exempted from certain taxes and dividend payments. At the same time they act like official export credit agencies in restricting financing to national exporters.[52]

37. Secretary Summers's analysis is confirmed by the Head of the OECD Trade Directorate and one of its specialists in export credits and financing. They define market windows as "institutions related to governments which are able to raise finance and lend at very low rates of interest but which may not currently follow all the provisions of the Arrangement."[53]

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[47] GOVERNMENT RESPONSE TO THE STANDING COMMITTEE ON FOREIGN AFFAIRS AND INTERNATIONAL TRADE (SCFAIT) REVIEWING THE EXPORT DEVELOPMENT ACT, pg. 12 (Exhibit Bra-28).

[48] EDC Reference Guide, pg. 26 (Exhibit Bra-23).

[49] *Id*., pg. 9 (Exhibit Bra-23).

[50] Testimony of EDC President Mr. Ian Gillespie before the Standing Committee on Foreign Affairs and International Trade, 6 November 1997, pg. 15 (Exhibit Bra-26).

[51] EDC 2000 Annual Report, pgs. 3, 14, 47 (Exhibit Bra-22).

[52] Lawrence H. Summers, "The Importance of Continuing to Fight Against International Trade Finance Subsidies," Remarks at the 65th Anniversary of the Export Import Bank, 16 May 2000, pg. 3 (emphasis added) (Exhibit Bra-29).

[53] Steve Cutts & Janet West, "The arrangement on export credits," *OECD Observer*, 1 April 1998, pgs. 12, 14 (Exhibit Bra-30).

38. While market windows may remain a matter of debate within the OECD, they are not a matter of debate within the WTO. A government export credit agency ("ECA") is a "government or any public body within the territory of a Member" within the meaning of Article 1. Whether a credit provided by an ECA is "official support" within the meaning of the *OECD Arrangement* is irrelevant for the purposes of the WTO. Since an ECA is a government entity, any credit it provides must meet WTO requirements. An ECA makes a financial contribution within the meaning of Article 1 whenever it makes loans or guarantees or provides other financial services. The only questions remaining are "benefit" and "contingent upon export," points that are discussed in Sections III.D and III.E, *infra*. If a market window operation meets these criteria, then it constitutes a prohibited subsidy unless it qualifies for the safe harbor of item (k).

39. The position Canada has taken throughout these disputes, that market window operations are private and need not be transparent, is particularly subversive of the WTO system because it leaves to Canada and Canada alone the right to decide, in secrecy, whether and how it will meet its international obligations. Canada's position is that when a potential transaction is presented to EDC, it is for EDC to decide whether the Corporate Account support it provides will be "official" or "unofficial." If the former, then, presumably, the transaction is transparent. But if EDC decides to use the market window, the transaction becomes "private" and transparency is not, in Canada's view, required. To be sure, Canada concedes that both kinds of support, official and unofficial, are subject to WTO rules. But as to whether those rules are being observed in market window transactions, Canada's position boils down to this: "Trust us." If the rule Canada sets for itself were adopted by the entire WTO Membership, the disciplines of the SCM Agreement with regard to export credits would be non-existent.

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C. EDC PROVIDES A FINANCIAL CONTRIBUTION TO REGIONAL AIRCRAFT

40. EDC offers "a wide range of financial services" to Canadian companies.[54] These financial services include credit insurance, financing services, bonding services, political risk insurance and

that Bombardier has with EDC, but it has a significant number."[59] One of those accounts, of course, would be for the Air Wisconsin transaction announced that same day by Minister Tobin.

43. Public information confirms that, in addition to the Air Wisconsin sale, the regional aircraft industry utilizes financial services from EDC in acquiring Bombardier aircraft:

- *Air Finance Journal* reports EDC's participation in financing a $112 million sale of eight Bombardier CRJ jets to the Australian regional airline, Kendell.[60] Bombardier announced the transaction in an October 1998 press release.[61]

- The US Regional carrier, ASA, in a 1997 10-Q Form, noted that in April 1997 it reached an agreement for the sale of 30 CRJs (with options for an additional 60 aircraft), valued at

44. Financing of the kind provided by EDC, such as that provided to Kendell and ASA, constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. It is a direct transfer of funds in the form of a loan. Moreover, financing by EDC of the kind announced by Minister Tobin for Air Wisconsin constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement, as a direct or potential direct transfer of funds.

45. Guarantees of the kind provided by EDC, such as those provided to Comair, also constitute a "financial contribution" within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. These are potential direct transfers of funds.

46. The provision by EDC of financial services in the form of export credits, including loans and guarantees, constitutes a "financial contribution" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement. These are services other than general infrastructure.

D. CONFERS A BENEFIT TO REGIONAL AIRCRAFT

1. Terms More Favourable than Provided for In the *OECD Arrangement* are Positive Evidence of a Benefit

47. The Panel in *Canada – Aircraft* determined that a benefit is conferred when a "financial contribution places the recipient in a more advantageous position than would have been the case but for the financial contribution."[69] The Appellate Body upheld this determination with specific reference to loans, loan guarantees, and the provision of services by a government, holding that a benefit arises under each of these "if the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market."[70] The available evidence demonstrates that the recipients of EDC's loans, loan guarantees and financial services obtain those financial contributions on terms more favourable than those available to them in the market.

48. As the previous *Canada – Aircraft* dispute made more than clear, the market for aircraft finance is characterized by an overall lack of transparency. Canada chooses not to disclose any of the details of the transactions in which it is involved. Participants in the market, such as airlines, appear to disclose only when legally required, as is sometimes the case with securities filings in the United States.

49. In an effort to discipline the extensive and secret government involvement in financing, including aircraft, the participants in the OECD created the *Arrangement* in 1978. The second paragraph of item (k) of Annex I to the SCM Agreement, the "Illustrative List of Export Subsidies," as noted above, specifies that export credits provided by any WTO Member – whether or not a member of the OECD – that are applied in conformity with the interest rates provisions of the *Arrangement*, are not prohibited.[71]

50. The *Arrangement* places limitations on the terms and conditions of export credits that benefit from official government support. It "sets out the *most generous* repayment terms and conditions that

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rate became an "effective" 7.2 percent rate. It does not state that EDC was involved in the transaction; however, Embraer has informed Brazil that its trade sources state that EDC was involved in the financing. Any information with regard to EDC's involvement is, of course, in Canada's sole possession, as noted in Brazil's 21 May letter to the Panel requesting that the Panel ask Canada to provide relevant information.

[69] WT/DS70/R, para 9.112.

[70] WT/DS70/AB/R, para. 158.

[71] *See supra* para. 28.

may be supported."[72] It establishes a level below which government export credit agencies should not go in providing credits in any form to support exports.

51. In *Brazil – Aircraft*, the Appellate Body concluded that the *Arrangement* is an appropriate benchmark against which to assess whether payments by governments are used to secure a material advantage in the field of export credit terms within the meaning of item (k) first paragraph.[73] The Appellate Body also noted that "benefit" and "material advantage" are different, and that item (k) and material advantage become an issue only when a subsidy – including a benefit – already is present. In other words, export support that confers a material advantage will always confer a benefit, but export support that confers a benefit will not always secure a material advantage.[74]

52. This analysis is consistent with that of the Article 21.5 Panel in *Brazil – Aircraft*, where the issue was whether an interest rate benchmark below the relevant Commercial Interest Reference Rate ("CIRR") of the *Arrangement* conferred a material advantage within the meaning of item (k) first paragraph. The Panel observed that the Appellate Body "identified the CIRR as a relevant benchmark under the material advantage clause because it represents the *'minimum* commercial interest rate' faced by a potential borrower in respect of a particular currency."[75] The Panel went on to observe that, "the CIRR is intended in principle to approximate the interest rate that first class borrowers would pay 'commercially,' *i.e.*, in private transactions not benefiting from official support."[76]

53. The fact that a net interest rate to a borrower is below the relevant CIRR is "positive evidence" that it secures a material advantage.[77] *A fortiori*, since material advantage has a lower threshold than benefit, a rate below the relevant CIRR is also positive evidence that a benefit is thereby conferred. While the Appellate Body in *Brazil – Aircraft* specifically was addressing interest rates and the first paragraph of item (k), its reasoning applies equally to the other terms and conditions of the *Arrangement.* The legal principle established in that case is that the *Arrangement* presumptively establishes the most favourable terms available in the market, and the granting of more favourable terms is positive evidence not only of material advantage, but also of a benefit.

54. In addition to the CIRR, the provision of the *Arrangement* most relevant to this proceeding is Article 21 of its *Sector Understanding on Export Credits for Civil Aircraft* which provides for a maximum repayment term for regional aircraft of 10 years.[78] Just as an interest rate below the CIRR is positive evidence of a material advantage, and, *a fortiori*, a benefit, so too a repayment term of more than 10 years for regional aircraft is positive evidence of a benefit. As Canada itself has said elsewhere:

> The second paragraph [of item (k)] provides an exception to the application of Article

> conformity with these provisions will not be considered an export subsidy prohibited under Article 3.[79]

The available evidence makes clear that Canada, through EDC, makes available export credits for regional aircraft at rates below the relevant CIRR and for terms in excess of 10 years.

2.

? Bombardier's sale of eight CRJs to Kendell Airlines, with financing by EDC, was for a period of 12 years.[87]

? At least a portion of the CRJs purchased by Comair with "government guarantees to the extent available" "were financed through operating leases with terms of up to 16.5 years."[88]

? The US regional carrier Atlantic Coast Airlines Holdings Inc., in a Form 10-K filed with the US Securities and Exchange Commission for the fiscal year ended 31 December 2000, reported that, "On March 14, 2001 the Company acquired through leveraged lease transactions its 41st CRJ aircraft. The lease terms are for approximately 16.8 years."[89]

? In a Form 10-K filed with the US Securities and Exchange Commission for the fiscal year 1998, the US regional airline ASA reported the purchase of more than 90 CRJs, and the delivery of 17 "through operating leases with 16.5 year terms." It then stated, "ASA obtained a commitment from the Export Development Corporation (EDC) of Canada to provide financing to ASA for up to approximately 85 per cent of the purchase price of the 45 CRJ-200 aircraft …. This facility … is available on an aircraft by aircraft basis in the form of either direct loans or leases, with interest payable at various interest rate options determined by reference to either US Treasury rates or

"absorb[s] the risk … beyond what is possible by other financial intermediaries," it is providing something those intermediaries – those *market* intermediaries – do not. All of this is simply another way of saying that EDC provides financial services, including export credits, "on terms that are more advantageous than those that would have been available to the recipient in the market".[95] Thus, all of this is another way of saying that EDC's provision of superior financial services confers a benefit.

4. Government Provision of Financial Services of a Quality Better than that Available in the Market is a Benefit

62. Before the Panel in the prior proceeding, Brazil quoted the statement of former EDC President Paul Labbé:

> EDC's financing support gives Canadian exporters an edge when they bid on overseas projects. … Trade deals increasingly depend on complex and tightly negotiated financing arrangements where a few basis points in interest rates can make or break the deal. Exporters are having to bid not just on the basis of quality and price, but also on the basis of the financing package supporting the sale.[96]

63. Brazil argued that Mr. Labbé's statement amounted to an acknowledgement that EDC provided an "edge" to Canadian exporters by "a few basis points," and that this was better than was available in the market.[97] Canada, however, argued that in referring to the "edge" provided by EDC, Mr. Labbé simply was referring to "the ability of EDC officials to assemble better structured financial packages on the basis of their knowledge and expertise".[98] The Panel concluded, and the Appellate Body agreed, that "this statement provides no firm guidance as to whether the EDC provides exporters with an 'edge' through subsidization."[99]

64. Subsequent statements by EDC officials echo Mr. Labbé's point. For example, his successor, Mr. Ian Gillespie, lauds the "skills and experience" of EDC's employees, and notes that, "EDC houses the largest pool of trade finance skills under one roof in Canada."[100]

65. The issue before the Panel in the prior proceeding concerned only financial contributions within the meaning of subparagraph (i) of Article 1.1(a)(1) – direct financing (loans), equity infusions, and guarantees. That proceeding did not involve the question of subparagraph (iii) of Article 1.1(a)(1) – the provision by government of services other than general infrastructure.[101] This proceeding explicitly involves both subparagraph (i) and subparagraph (iii).

66. Brazil continues to believe that the most reasonable interpretation of the ordinary meaning of Mr. Labbé's words is that they admit that EDC provides support in the form of credits "a few basis points" below the market. We are told, however, that by referring to an "edge" amounting to a "few basis points", Mr. Labbé merely was referring to "the ability of EDC officials to assemble *better structured financial packages* on the basis of their *knowledge and expertise*". If so, there is still a benefit. Government provision of ability, knowledge and expertise through financial services superior to those the recipient otherwise could obtain in the market – through "better structured financial packages" – also constitutes the conferral of a benefit.

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[95] WT/DS70/R, para. 9.112.
[96] WT/DS70/R, para. 6.57.
[97] WT/DS70/R, para. 6.58.
[98] WT/DS70/R, para. 9.163.
[99] WT/DS70/R, para. 9.164; WT/DS70/AB/R, para. 213.
[100] EDC 2000 Annual Report, pg. 4 (Exhibit Bra-22).
[101] *See, e.g.*, WT/DS70/R, paras. 6.1 - 6.6.

67. Despite Canada's claim that EDC is just another bank, these skills, this "knowledge and expertise", this ability "to assemble better structured financial packages", are made available *only* to Canadian exporters. In the field of regional aircraft, only Bombardier may take advantage of the "edge" EDC provides through its superior services. Embraer is not eligible. Nor is any other player in the market eligible for these services which are, by Canada's own description, superior to those available in the market to Bombardier, its customers, and everyone else. Thus, through its admitted provision of services superior to those available in the market, other than general infrastructure, only to Canadian firms and their customers, EDC provides a benefit to those firms.

5.

F. CANADA PROVIDES PROHIBITED SUBSIDIES THROUGH EDC

73. The publicly available evidence, as noted in Brazil's 21 May letter to the Panel, is only the tip of the iceberg. Nonetheless, this evidence makes clear that, through EDC, and, in particular its market window operations, Canada provides prohibited export subsidies. EDC was established to support exports by providing financial services that the market does not provide. EDC "complements" the market. It provides interest rates below the CIRR and for terms that exceed 10 years. Yet the CIRR and 10 years are, in the words of the *OECD Arrangement*, "the most generous repayment terms and conditions that may be supported". The Appellate Body has concluded that terms more generous than those provided by the *OECD Arrangement* are positive evidence of a material advantage; such terms are, *a fortiori*, positive evidence of a benefit. EDC, by its own description, provides financial services to Canadian exporters – and only to Canadian exporters – superior to these and superior to those the exporters could obtain elsewhere. Provision of these services is contingent in law upon export. They therefore constitute a prohibited export subsidy.

IV. CANADA ACCOUNT

74. The Canada Account was, and remains, a prohibited export subsidy. It is also a measure shrouded in secrecy. Until the 10 January press conference by Minister Tobin with respect to the Air Wisconsin transaction, virtually nothing has been said or disclosed by Canada concerning the Canada Account since Brazil's initial challenge to the measure began. The news release issued in connection with Minister Tobin's 10 January press conference described Canada Account and its relationship to EDC:

> The Export Development Corporation (EDC) has a mandate to support and develop Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities. The Corporation is financially self-sufficient

76. Following adoption of the report in *Canada – Aircraft*, Canada attempted to shelter the Canada Account in the safe haven of the second paragraph of item (k) to Annex I of the SCM Agreement. This attempt was rejected by the Article 21.5 Panel that considered the issue.[110] In particular, Canada attempted to conform the Canada Account to its WTO obligations by agreeing to comply with the entire *OECD Arrangement*, including its matching provisions. The Panel, noting that item (k) referred only to the "interest rates provisions" of the *Arrangement*, and not to all of its provisions, explicitly disagreed with Canada.[111] Yet, it was these same matching provisions to which Minister Tobin referred in his press conference when asked to justify Canada's actions.[112] The $2.35 billion Air Wisconsin deal was confirmed by Bombardier on 16 April 2001, with International Trade Ministry spokesman Sebastian Theberge stating that "the deal is in essence the one announced [by Mr. Tobin]".[113]

77. Canada's use of the Canada Account to support Bombardier's sale of aircraft to Air Wisconsin constitutes a prohibited subsidy.

A. CANADA ACCOUNT PROVIDES A FINANCIAL CONTRIBUTION

78. Canada Account offers four major financial services to support Canadian exporters: export credits insurance, financing services, performance insurance, and political risk insurance.[114] These constitute either a "direct transfer of funds" or a "potential direct transfer of funds or liabilities," under Article 1.1(a)(1)(i) to the SCM Agreement. In discussing Canadian support for the Air Wisconsin transaction, Minister Tobin stated that it would take the form of a "loan," which constitutes a direct or potential direct transfer of funds, within the meaning of Article 1.1(a)(1)(i).**[115]** All of these export credits, whatever their form, also constitute the provision of services other than general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the Agreement.

B. CANADA ACCOUNT CONFERS A BENEFIT

79.

84. IQ's powers are broad. The IQ Act provides that, "where a project is of major economic significance for Québec", the Government may "mandate the agency to grant and administer the assistance determined by the Government to facilitate the realization of the project".[128] The IQ Act

lower the current tax bill of the investors over the life of the lease. In addition, when the debt is retired and the lease is terminated, the investors are the owners of the aircraft and are able to claim what is called its "residual value". The profits realized from any sale of the aircraft at this point are treated as "capital gains" and are taxed at a lower rate in jurisdictions whose tax laws favour this type of transaction.

89. The investors face two major risks. One is that the aircraft may have little value at the end of the lease. Investors usually are protected from this risk by the strict maintenance requirements that apply to aircraft, and by a "residual value guarantee" usually provided by the manufacturer.[131] The other risk faced by the investors is default by the airline during the life of the lease. Should default occur, the creditors – those who furnished the 80 per cent debt capital of the corporation – would be entitled to repossess the aircraft to satisfy their claims. This would deny the investors the benefit of tax write-offs from that point forward. It also could deprive them of their assets – the aircraft – when the aircraft are sold to satisfy the claims of the debtors. The price realized at sale may not be sufficiently in excess of the amount necessary to satisfy the debt, and therefore leave the investors with a partial or even a full loss. A first loss deficiency guarantee protects investors from this risk.

90. On at least one occasion, IQ has offered such a guarantee to equity investors in a corporation established to purchase Bombardier aircraft. Brazil's Exhibit 49 is a portion of a memorandum to potential equity investors in a corporation to be established to purchase and lease aircraft manufactured by Bombardier. The memorandum states that the transaction will involve a leveraged lease with a term of up to [] years. It then specifies:

[[132]]

91. While this transaction is the only documentary evidence currently available to Brazil concerning IQ's investment guarantees, Brazil has been informed by Embraer that Quebec provided support, which Embraer believes was in the form of equity guarantees, to facilitate Bombardier sales of CRJ 200 regional jets to Atlantic Southeast, Midway, and Northwest Airlines during the late 1990s. Any information with regard to these transactions is solely within Canada's possession. That information is included in Brazil's 21 May letter to the Panel requesting that the Panel ask Canada to provide relevant information.

A. IQ PROVIDES A FINANCIAL CONTRIBUTION TO REGIONAL AIRCRAFT

92. The provision of financial services in the form of loans and guarantees ("suretyship") constitute financial contributions within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement. These would include the specific examples cited by Brazil: the guarantee described by M. Cyr and the guarantee provided to equity investors. These financial services also constitute services other than general infrastructure within the meaning of Article 1.1(a)(1)(iii) of the Agreement.

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[131] Embraer has reported to the Government of Brazil that its sales personnel have been told by potential airline customers that Bombardier offers a government-backed residual value guarantee. However, Brazil has no documentation to support these statements. This information is within the sole possession of Canada, as noted in Brazil's letter to the Panel of 21 May 2001.

[132] [] (Exhibit Bra-49). Under the terms of Article 16 of the Panel's Working Procedures, Brazil requests that this confidential bracketed quotation be excluded from the version of this submission attached to the Panel Report.

B. IQ PROVIDES A BENEFIT TO REGIONAL AIRCRAFT

93. The words of the [] – echo the words of Canada in the *Brazil – Aircraft* Article 21.5 review, that, in the case of loan guarantees, "the lending bank establishes financing terms in the light of the risk of the [government], not the borrower".[133] In this case, there does not appear to be a loan guarantee, only an equity guarantee. But the principal is the same. The full faith and credit of the Government of Quebec insures the equity investors against loss.

94. Indeed, a guarantee to equity investors is an even greater benefit than a loan guarantee. Equity investors normally are the risk takers in a transaction. In exchange for the potential rewards of ownership, they take the risk of failure. A guarantor that removes or reduces this risk accepts the entire risk of the market system with no potential for its rewards. A guarantor of a loan, in contrast, normally has the security of the loan collateral to reduce its exposure, plus the fact that over time, as the loan is amortized, that exposure is reduced. A guarantor of an equity investor does not enjoy even this security. Indeed the reverse might be the case, since the entire capital contributed by the equity investors is at risk throughout the lease.

95. So unusual are equity guarantees that they are not even mentioned by name in the text of the Agreement, as are loan guarantees. Beyond this, they do not even appear to be available commercially. After being told by potential customers that Bombardier was able to offer potential investors in leasing corporations a guarantee, Embraer made inquiries to determine whether it could obtain similar guarantees. Embraer was told that these guarantees are not available in the market.[134]

96. A government loan guarantee confers the government's credit rating on a private party and thereby confers a benefit by making a borrower more credit worthy than it otherwise would be in the market. Totally apart from a potentially more favourable credit rating, however, a loan guarantee adds to the security of lender by making an additional party responsible for the debt. This also confers a benefit by making any borrower more credit-worthy than it otherwise would be. Government guarantee to an equity investor, protecting that investor from the risks inherent in the equity market, confers a benefit by making equity capital available to finance aircraft transactions on terms more favourable to the other parties than would be the case in the market in the absence of the guarantee.

C. IQ IS CONTINGENT UPON EXPORT

97. Article 25 of the IQ Act specifies "export activities" as one of the missions of IQ. IQ regulations confirm that the programme is contingent in law upon export.

98. While IQ can support a variety of projects, where a project is related to the sale of goods such as aircraft, receipt of IQ funds is explicitly contingent on the export of those goods. Decree 572-2000, regarding the fund for private sector investment growth, enables IQ to provide financial support for investment projects or export projects.[135] The Decree then specifies that "exportation" includes, among other things, the sale of goods, but only if that sale is outside of Quebec.[136] Similarly, Decree 841-2000 grants IQ authority to support market development projects,[137] which it defines to include,

[133] WT/DS46/RW, Annex 1-2, para. 36.
[134] *See* bank letters included in Exhibit Bra-50.
[135] Décret 572-2000, 9 mai 2000, Concernant le programme du Fonds pour l'accroissement de l'investissement privé et la relance de l'emploi, Art. 1 (Exhibit Bra-19).
[136] *Id*., Art. 2.
[137] Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises, Art. 2 (Exhibit Bra-20).

among other things, projects ultimately focused on the sale of goods, but again only if the sales at issue are outside of Quebec.[138]

99. Thus, wherever IQ supports the sale of aircraft, it does so only on the condition that the recipient export those aircraft outside of Quebec. This is the very definition of "contingent in law . . . upon export performance", within the meaning of Article 3.1(a) of the SCM Agreement. As a matter of law, a potential recipient must demonstrate that the aircraft will be exported. In every instance in which it is used to support regional aircraft transactions, therefore, IQ is, as such, a prohibited export subsidy.

100. IQ's regulations contain further evidence of its export contingency. Decree 841-2000 provides for financing to support something called an "export credit margin":

> The level of an export credit margin is determined according to the short-term financing needs of the firm and the guarantee is accorded according to the market development activities of the firm and of *the Quebec content of the products and services that it exports*.[139]

101. The loan guarantee fund established in 1996 specifically for Bombardier and the equity guarantee provided by Quebec for investors further demonstrate the *de jure* export contingency of IQ's subsidies. Virtually all of Bombardier's regional aircraft production is exported. Even the launch sale to the domestic carrier, Air Canada, was structured as an export sale and received financing from EDC.[140] To paraphrase the Panel in *Australia – Leather*, it is clear that the Canadian market for aircraft is too small to absorb Bombardier's production, much less any expanded production that might result from the financial benefits accruing from subsidies.[141]

102. IQ's export contingency is further demonstrated by the equity guarantees IQ furnishes to support leveraged lease transactions.[142] The very purpose of leveraged lease transactions is to take advantage of the favourable tax treatment provided by the laws of the jurisdiction of ownership. The tax laws of five countries – France, Germany, Japan, the United Kingdom, and the United States – cause almost all, if not all, of the world's leveraged lease transactions to be based on one of them. The tax laws of Canada virtually assure that no leveraged lease will be based in Canada. In fact, "tax-based lease financing, other than for certain exempt property, is almost non-existent" in Canada.[143] In this regard, Brazil recalls the testimony of Mr. Paul Labbé, the then-president of EDC, who, in justifying EDC's support of a seemingly domestic sale to Air Canada, told the Canadian Parliament that a "tax vehicle" had been established in the United States, and that this "tax vehicle" acquired the aircraft, thereby qualifying the transaction as an export, and then leased the aircraft to Air Canada.[144]

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[138] *Id*., Art 3 ("'développement de marchés': . . . – la commercialisation . . . pour l'accroissement de ventes . . . à l'extérieur du Québec; – la vente de biens . . . à l'extérieur du Québec; – l'acquisition d'une entrepirse ou d'un réseau de distribution pour la vente de biens . . . à l'extérieur du Québec; – la formation d'un groupement d'entreprises à des fins de vente de biens . . . à l'extérieur du Québec . . . .").

[139] Décret 841-2000, 28 juin 2000, Concernant le Programme d'aide au financement des entreprises, Art. 7 (English translation) (Exhibit Bra-20).

[140] *See supra* para. 72.

[141] *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/R, para. 9.67 (25 May 1999) (Adopted 16 June 1999) ("[I]t is clear that the Australian leather market for automotive leather is too small to absorb Howe's production, much less any expanded production that might result from the financial benefits accruing from the grant payments . . .").

[142] Offering Memorandum (Exhibit Bra-49).

[143] Monica Biringer, "Cross-Border Equipment Leasing May Reduce Financing Costs for Canadian Users," 5 *Journal of International Taxation* 230 (May 1994) (Exhibit Bra-51).

[144] Testimony of EDC Officials, House of Commons of Canada, 35th Parliament, 1st Sess., Standing Committee on Foreign Affairs and International Trade, Meeting No. 43, pg. 43:30 (Exhibit Bra-45).

D. CANADA PROVIDES PROHIBITED SUBSIDIES THROUGH IQ

103. The publicly available evidence concerning the operations of IQ, like the publicly available evidence concerning EDC, is only the tip of the iceberg.[145] Nonetheless, that evidence makes clear that, at a minimum, through IQ guarantees, Canada provides prohibited export subsidies. Those guarantees are financial contributions that confer a benefit by absorbing risk that would otherwise fall upon the participants in the transactions. They are contingent, in law or in fact, upon export. They are, therefore, prohibited by the Agreement.

VI. CONCLUSION

104. This is a dispute about subsidies, but it is more than that. As a subsidies dispute, the activities of EDC, the Canada Account, and IQ are at issue. The evidence Brazil has presented demonstrates conclusively that, through each of these mechanisms, Canada provides a subsidy that is contingent upon export, and Brazil requests that this Panel so determine, as set out in Brazil's request for the establishment of the Panel.

105. At a broader level, however, this is a dispute about transparency and the functioning of the WTO dispute settlement system as it relates to subsidies. None of the Canadian programmes that are the subject of this dispute has even been notified to the Committee on Subsidies and Countervailing Measures pursuant to Article XVI:1 of the GATT 1994 and Article 25 of the SCM Agreement.[146] At consultations, Canada declined to provide information in response to Brazil's questions, and, indeed, Canada's delegation to the consultations stated that it was totally unprepared even to talk about IQ. In the prior proceeding, Canada adamantly refused to cooperate in providing relevant information in its sole possession, even when requested to do so by the Panel. Canada went so far as to argue that it had no duty to cooperate.[147]

106. Thus, what is at issue here is not only the consistency or inconsistency of Canada's programmes with its WTO obligations, but, perhaps even more important, the consistency or inconsistency of Canada's obligations of transparency and good faith cooperation. The Panel's determination on the merits of this dispute will have very important implications for the standards that apply to export credits in the WTO. The Panel's determination on the issues of transparency and good faith that have been raised by Canada's stance in this and in the prior dispute will have very important implications for the standards that apply not just to export credits, but to all disputes in the WTO.

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[145] *See supra* para. 73.

[146] The latest Canadian notification is dated 9 May 2000. G/SCM/N/48/CAN. Perhaps Canada's next notification will rectify the apparent oversight.

[147] WT/DS70/AB/R, para. 186.

ANNEX A-4

RESPONSE OF BRAZIL TO SUBMISSION OF CANADA REGARDING JURISDICTIONAL ISSUES

(22 June 2001)

1. The Panel has asked Brazil to respond to Canada's preliminary submission regarding the Panel's jurisdiction, dated 18 June 2001.[1] In that submission, Canada claims that certain of Brazil's claims are inconsistent with Articles 6.2 and 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU").

I. BRAZIL'S CLAIMS WITH RESPECT TO THE CANADA ACCOUNT ARE CONSISTENT WITH ARTICLE 21.5 OF THE DSU

2. Canada argues that Brazil cannot challenge, in proceedings brought pursuant to Article 6 of the DSU, the existence or consistency with the covered agreements of measures taken to comply with the earlier recommendations and rulings of the DSB with respect to Canada Account.[2] Rather,

9. Therefore, to consolidate the review of its "as such" and "as applied" claims, Brazil considered it preferable to bring all of those claims before this Panel, rather than bringing some of those claims before an Article 21.5 panel. To require Brazil to have split its claims between two panels – one constituted under Article 21.5 and one under Article 6 – would not be justified by the ordinary meaning of the provisions concerned, and would not be consistent with the object and purpose of Article 21.5 of the DSU.

10. This is particularly true where, as here, no measure to comply has been taken. Here, Brazil has not challenged a measure taken to comply under Article 21.5, but rather has chosen to challenge Canada Account anew as a "measure" under Article 6.2, in accordance with the ordinary meaning of that provision.

11. Finally, following adoption of the Article 21.5 Report, Brazil chose not to exercise its rights, under Article 22.6 of the DSU, to suspend concessions. Instead, it chose to negotiate with Canada with a view to resolving these disputes. In the meantime, the 30-day period for requesting authorization to suspend concessions under Article 22.6 passed. Certainly, Canada does not suggest

16. The Appellate Body has on several occasions described the purpose behind the requirements of Article 6.2. In *European Communities – Regime for the Importation, Sale and Distribution of Bananas*, the Appellate Body stated that "precision" in a request for establishment is important for two reasons:

> First, it often forms the basis for the terms of reference of the panel pursuant to Article 7 of the DSU; and, second, it informs the defending party and the third parties of the legal basis of the complaint.[9]

17. In *Brazil – Measures Affecting Desiccated Coconut*, the Appellate Body referred to these same two purposes in slightly different terms. The Appellate Body stated that a "specific" request for establishment establishes the "jurisdiction of the panel by identifying the precise claims at issue in the dispute", and fulfills a "due process objective", facilitating a response to the complainant's case by other parties and third parties.[10]

18. To fulfill these dual objectives, in its Report in *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, the Appellate Body imposed four specific requirements on a request for establishment:

> The request must: (i) be in writing; (ii) indicate whether consultations were held; (iii) identify the specific measures at issue; and (iv) provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly.[11]

As shown below, Brazil's request meets each of these criteria.

1. Requirements (i) and (ii)

19. Brazil's request for establishment of this Panel is in writing, and indicates that consultations were held but did not resolve the dispute. Thus, the first two requirements set out in *Korea – Dairy* are satisfied.

2. Requirement (iii)

20. Brazil's request also satisfies the third requirement discussed in *Korea – Dairy*; namely, that the request for establishment identify the specific measures at issue. For the three Canadian programmes at issue – Canada Account, the Export Development Corporation ("EDC"), and Investissement Québec ("IQ") – Brazil has identified the specific categories of support subject to its challenge. Numbered paragraph 1 of its request states that Brazil is challenging Canada Account "export credits, including financing, loan guarantees, or interest rate support . . . ". Numbered paragraph 5 states that Brazil is challenging EDC "export credits, including financing, loan guarantees, or interest rate support . . . ". Finally, numbered paragraph 7 states that Brazil is also challenging IQ "export credits and guarantees . . . , including loan guarantees, equity guarantees, residual value guarantees, and 'first loss deficiency guarantees' . . .".

21. Brazil's request specifically not only covers challenges to these measures *as such*, but states clearly that it is also a challenge to the measures *as applied* in, *e.g.*, the Air Wisconsin transaction. Finally, contrary to Canada's claim at paragraphs 42, 51 and 56, the very first paragraph of Brazil's request states that it is only concerned with these measures with respect to their role in regional

aircraft transactions. Brazil also notes that the title of the dispute is *Canada – Export Credits and Loan Guarantees for Regional Aircraft*.[12]

22. Canada's principal complaint appears to be that Brazil's claims are "extremely broad," "so broad as to defy definition", and that they "could potentially cover hundreds of clients and many thousands of transactions since 1995".[13] Canada appears to suggest that a claim must be narrow to satisfy Article 6.2 of the DSU.

23. Article 6.2 contains no such requirement. Brazil is entitled to raise broad claims that entire Canadian programmes are inconsistent with Canada's obligations under the SCM Agreement. Broadly-defined measures, such as the US tax treatment of foreign sales corporations, have often been the subject of WTO disputes, in circumstances where those measures would affect many more than the "hundreds" of clients affected by Brazil's claims against the Canada Account, EDC and IQ. It is a Member's prerogative to challenge any measure, no matter how broad, that it considers is inconsistent with another Member's WTO obligations.

24. In any event, Brazil notes that its claims are not nearly as broad as they could be. As noted above, Brazil's request clarifies that it is only concerned with the Canada Account, EDC and IQ with respect to their role in regional aircraft transactions. Moreover, it has limited those claims to particular forms of support provided by or through the Canada Account, EDC and IQ. Canada Account uses types of support not included in Brazil's claims, including export credits insurance, performance insurance, and political risk insurance.[14] EDC similarly provides various types of support not subject to Brazil's claims, such as accounts receivable insurance, bonding, and political risk insurance. IQ also extends support not included in Brazil's claims, such as suretyship[15] and exchange rate guarantees.[16] For these reasons, Brazil's request complies with the third requirement set forth in *Korea – Dairy*.

3. Requirement (iv)

25. As noted above, the Appellate Body stated in *Korea – Dairy* that the fourth requirement flowing from Article 6.2 of the DSU is the inclusion in a request for establishment of "a brief summary of the legal basis of the complaint sufficient to present the problem clearly".[17] The Appellate Body emphasized that as long as the legal basis is identified and presents the problem clearly, "Article 6.2 demands only a summary – and it may be a brief one – of the legal basis of the complaint".[18]

26. As discussed above, Brazil's request for establishment of the Panel includes three overarching claims, against support by or through the Canada Account, EDC and IQ for the Canadian regional

[12] In any event, in *European Communities – Customs Classification of Certain Computer Equipment*,A.75 24s(24.) Tj 36

aircraft industry. Brazil also expressly states in numbered paragraphs 1, 5 and 7 that those measures are prohibited export subsidies, within the meaning of Articles 1 and 3 of the SCM Agreement.[19]

27. Brazil has done more than simple "identification of the treaty provisions claimed," however. To ensure that the problem is presented clearly, as required by the Appellate Body in *Korea – Dairy*, numbered paragraphs 1 through 7 include details, discussed above, of the specific categories of support involved.

4. Attendant Circumstances

28. Even had Brazil done nothing more than simply identify the treaty provisions involved, that would have been adequate to protect Canada from prejudice to its interests, or from harm to its due process rights. As the Appellate Body in *Korea – Dairy* has explained, the determination whether a defending party's Article 6.2 due process rights are harmed does not rest solely on the text of the request for the establishment of a panel.[20] Instead, as the Appellate Body in *Thailand – Anti Dumping Duties on Angles, Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland* notes, "The fundamental issue in assessing claims of prejudice is whether a defending party was *made aware of* the claims presented by the complaining party, sufficient to allow it to defend itself."[21] Thus, the "simple listing of the articles of the agreement or agreements involved may, in the light of [the] *attendant circumstances* [of the dispute], suffice to meet the standard of *clarity*" required by Article 6.2 that is necessary to protect a Member's due process rights.[22] In resolving whether a defending party's due process rights are harmed by "the simple listing of the articles of the agreement" involved in the dispute, a Panel may, among other things, "take into account . . . the actual course of the panel proceedings".[23]

29. The "attendant circumstances" in this case demonstrate that Canada's ability to defend itself has not been prejudiced. As noted in Brazil's first written submission, the Canada Account, EDC and IQ – the three programmes included in its request for establishment – were also challenged in an earlier dispute, *Canada – Measures Affecting the Export of Civilian Aircraft.* That dispute began in March 1997 with Brazil's request for consultations,[24] which was followed by a request for the establishment of a panel in July 1998.[25] In its initial phase, the dispute led to the release of a panel report in April 1999[26], and an Appellate Body report in August 1999.[27]

30. Brazil's challenge to Canada's implementation of the panel and Appellate Body reports led to the establishment of a panel in November 1999 under Article 21.5 of the DSU[28], a report by that panel in May 2000,[29] and a report by the Appellate Body in July 2000.[30] Consultations were requested by Brazil with respect to these very same programmes in January 2001.[31] As required by Article 4.2 of

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[19] As noted above, numbered paragraphs 2-4 expand further upon the overarching claim regarding Canada Account included in numbered paragraph 1, which includes citation to Articles 1 and 3 of the SCM Agreement. Thus, it was not necessary for Brazil to cite to those same provisions yet again in numbered paragraphs 2 through 4.

[20] WT/DS98/AB/R (Adopted 22 June 1998), para. 127.

[21] WT/DS122/AB/R (12 March 2001) (Adopted 5 April 2001) para. 95 (emphasis supplied).

[22] WT/DS98/AB/R (Adopted 22 June 1998), para. 127 (emphasis supplied).

[23] WT/DS98/AB/R (Adopted 22 June 1998), para. 127.

[24] WT/DS70/1 (14 March 1997).

[25] WT/DS70/2 (13 July 1998).

[26] WT/DS70/R (14 April 1999) (Adopted 20 August 1999).

[27] WT/DS70/AB/R (2 August 1999) (Adopted 20 August 1999).

[28] WT/DS70/9 (23 November 1999).

[29] WT/DS70/RW (9 May 2000) (Adopted 4 August 2000).

[30] WT/DS70/AB/RW (21 July 2000) (Adopted 4 August 2000).

[31] WT/DS222/1 (25 January 2001).

the SCM Agreement, Canada was provided with a statement of available evidence illustrating the basis for Brazil's concerns.[32] Consultations were held in February 2001. During those consultations, specific and detailed questions were put to Canada by Brazil.[33] Brazil submitted an extremely specific letter to the Panel on 21 May 2001 in which it further detailed its claims against Canada. Brazil's First Written Submission, filed nine days later on 30 May 2001, two weeks after Canada's 16 May letter, also fully detailed all of Brazil's claims.

31. In addition, throughout this entire period, in an effort to resolve these disputes outside the auspices of WTO dispute settlement, Brazil and Canada, at the very highest diplomatic and political levels, have engaged in bilateral discussions on these very same programmes and issues.

32. Finally, and perhaps most importantly, despite Canada's purported confusion as to the subject matter of the current dispute and Brazil's request for the establishment of a panel, Canada's First Written Submission, filed 18 June 2001, contains a detailed and specific defence of its Canada Account, EDC and IQ regional aircraft financing programmes, both "as such," and "as applied" in the specific context of the Air Wisconsin and other transactions. This detailed defence thus responds to each of the claims Brazil raised in its request for the establishment of a panel to consider Canada's regional jet financing activities.

33. For these reasons, it is not credible for Canada to claim that Brazil's claims are not stated with sufficient clarity, or that its right to present a defence has been prejudiced. In the words of the Appellate Body in *Korea – Dairy*, the "attendant circumstances" suggest that Canada is very much aware of the issues and claims involved and, as such, has been and will continue to be able to vigorously defend itself.

34. Canada's 16 May 2001 request to Brazil for clarification of its claims, and Brazil's 21 May 2001 response to this request, does nothing to change these "attendant circumstances."

35. In paragraph 34 of its preliminary submission, Canada cites to the Appellate Body's statement in *Thailand – Anti-dumping Duties on Angles, Shapes and Sections of Iron or Non-alloy Steel and H-Beams from Poland* that "nothing in the DSU prevents a defending party from requesting further clarification on the claims raised in a panel request from the complaining party, even before the filing of the first written submission".[34] At paragraphs 58-59 of its preliminary submission, Canada states

[34]

a new "litigation technique"[36], encouraging Members to avail themselves of procedural counterclaims where none otherwise exist.

37. In any event, in addition to the attendant circumstances described above, Brazil notes that it provided considerable detail regarding its claims and evidence in its 21 May letter asking the Panel to exercise its authority under Article 13.1 of the DSU to request documentary evidence from Canada regarding the terms of Canada Account, EDC and IQ support for the Canadian regional aircraft industry. Absent a requirement in the DSU or the Panel's working procedures requiring even more detail, Brazil was thus entitled to present its case in its first written submission.

III. CONCLUSION

38. For the foregoing reasons, Brazil's request for establishment of this Panel is consistent with the terms of Articles 6.2 and 21.5 of the DSU. Brazil therefore requests that the Panel reject Canada's argument that certain of Brazil's claims are outside the jurisdiction of the Panel and should therefore not be considered on their merits.

[36] WT/DS122/AB/R (12 March 2001), para. 97.

ANNEX A-5

COMMUNICATION OF 25 JUNE 2001 FROM BRAZIL TO THE PANEL

(25 June 2001)

Secretary to Panel
Canada – Export Credits and Loan Guarantees for Regional Aircraft

25 June 2001

Please find attached correspondence between the Brazilian Mission in Geneva and Embraer, which is provided in response to the request of the Panel *Canada - Export Credits and Loan Guarantees for Regional Aircraft* (DS222), dated 20 June 2001, that the parties submit certain factual information relevant to this dispute.

Best regards,

Roberto Azevedo

(UNOFFICIAL TRANSLATION)

[ ]
[ ]

20 June 2001

[ ]

The WTO Panel examining the Canadian export credit programmes has asked Brazil in an urgent and confidential communication dated today, 20 June, for the full details of the terms and conditions of Embraer's offer of financing to Air Wisconsin. The deadline for the response expires on 25 June next, Monday.

Therefore we would appreciate receiving a response from you as soon as possible.

Sincerely,

Celso Amorim
Ambassador

ANNEX A-6

ORAL STATEMENT OF BRAZIL REGARDING JURISDICTIONAL ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

1. On 22 June, we responded to Canada's allegation that Brazil's request for establishment of this Panel was inconsistent with the terms of Article 6.2 and 21.5 of the DSU. The EC also provided its views on this issue in its 22 June third party submission.

2. I will not repeat here the views already expressed in Brazil's 22 June submission other than to note that Brazil's request for the establishment of a Panel in this case was simple and straightforward. Brazil stated clearly that this dispute involved export credits and guarantees for regional aircraft provided through three Canadian programmes – Canada Account, EDC and Investissement Québec. Brazil made clear that it challenged each of those programmes as prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement. These are the only articles of the covered agreements at issue in this dispute. Brazil also referred to offers or grants by Canada under these programmes that gave rise to Brazil's request.

3. Put simply, Brazil has asked the Panel to make yes or no determinations as to whether these three programmes – and specific transactions within those programmes – constitute prohibited export subsidies within the meaning of Articles 1 and 3 of the SCM Agreement. Brazil also has asked that you make specific factual findings, which you are empowered to do by Article 11 of the DSU.

4. Obviously, as everyone is aware from the written submissions before the Panel and the entire

ANNEX A-7

ORAL STATEMENT OF BRAZIL REGARDING SUBSTANTIVE ISSUES AT THE FIRST MEETING OF THE PANEL

(27 June 2001)

Mr. Chairman, Members of the Panel, Representatives of the WTO Secretariat, and Members of the Canadian Delegation:

1.

his press conference whether he had informed Brazil of Canada's action, he responded, "I just did."[2] Mr. Tobin was correct. Brazil first learned of Canada's claim that Brazil was offering support to Embraer from reports of his press conference.

8. Third, and most important, Embraer made its offers to Air Wisconsin without any support of any kind whatsoever from the Government of Brazil or from any entity controlled by the Government of Brazil. Embraer had no support from PROEX, the Brazilian subsidy programme that has been the subject of other disputes. It had no support from the BNDES, the Brazilian development bank that Canada has complained of in other contexts. Embraer's offers were for its own account and at its own risk. The terms of those offers are detailed in the 25 June response Brazil provided to the Panel's

guarantees. Next, I will review why the superior services EDC offers are themselves financial contributions within Brazil's "as such" claim. All of these financial contributions confer benefits "as such," are *de jure* export contingent, and are therefore prohibited.

A. Market Windows

15. Nearly all financial contributions by EDC's Corporate Account, whether in the form of loans or loan guarantees, are so-called "market window" operations. This issue was discussed at length in Brazil's First Written Submission. There is relatively little direct evidence of how exactly EDC's market window lending activities work, given Canada's reluctance to provide information.

16. Several points can be made, however, which demonstrate that whenever EDC operates through the "market window," it grants export subsidies "as such." As an agent of the Government of Canada, EDC borrows at Canada's sovereign rate, pays no income taxes, and is not expected to pay dividends. Despite this inherently low cost of funds – something no commercial institution enjoys – EDC does not consider itself constrained by the same OECD Export Credit Arrangement disciplines placed upon the government export credit agencies of the other Participants. As long as it does not extend support below "what the relevant borrower has recently paid in the market for similar terms and with similar security,"[4] EDC considers itself free to ignore the limitations placed on export credit agencies by the OECD Arrangement. Among other points, it is not clear how Canada defines the words "recently" and "similar". It claims to operate, instead, as a market-based institution in direct competition with private financial institutions and exporters, including exporters in developing countries.

17. EDC does not, in fact, operate as a market-based financial institution. A market-based financial institution, for example, would not limit its support to Canadian exporters, but EDC does exactly that. This behaviour is typical of a governmental export credit agency, not a private bank. A market-based financial institution's shareholders would demand that it support any transaction and any customer, regardless of nationality, provided it considered the transaction sufficiently profitable. EDC supports only Canadians, with the goal of obtaining "a competitive advantage for Canadian exporters, not just a level playing field."[5] To obtain this "competitive advantage," EDC retains the discretion and has the incentive to pass along the benefits of its extraordinarily low cost of funds to Canadian exporters.

18. The United States, at paragraph 5 of its third party submission, confirms Brazil's point that market window operations are largely free of market constraints. Such operations "are in a position to confer benefits by exceeding, if sometimes only in a small way, what purely market-based financial institutions can (or may be willing) to offer. Their ability to do so explains their existence, since *there would otherwise be no reason for market windows to exist* in parallel with private financial market actors, much less any logical reasons for governments to limit their market window activities to nationals."

19. EDC and its market window operations "as such" are inconsistent with Canada's obligations under the Subsidies Agreement. The sole reason for their existence, and their only logical use, is to provide what the market does not provide – support on terms better than its clientele, Canadian exporters and their customers, could otherwise obtain on the market.

20. Further, export credits in any form can also confer a benefit by reducing, if not eliminating, the need of the seller to lower its price to remain competitive. When

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[4] Canadian First Written Submission, para. 67 (emphasis removed).

[5] Testimony of EDC President Mr. Ian Gillespie before the Standing Committee on Foreign Affairs and International Trade, 6 November 1997, pg. 15 (Exhibit Bra-26).

developing, directly or indirectly, Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."[11]

C. Services

26. Under the third subparagraph of Article 1.1(a)(1) of the Subsidies Agreement, financial contributions can take the form of "services other than general infrastructure." EDC provides various types of assistance to the Canadian regional aircraft industry and its purchasers. Its financing support and financing packages for Canadian regional aircraft purchasers, as well as the financing and loan guarantees that are part of that support and those packages, are examples.

27. Canada has acknowledged that EDC provides its financing support and financing packages on terms more favourable than a recipient could receive on the market. According to the EDC, it "*complements* the banks and other financial intermediaries," and absorbs risk for Canadian exporters "*beyond what is possible* by other financial intermediaries."[12] Additionally, "EDC's financing support gives Canadian exporters an *edge* when they bid on overseas projects,"[13] which – Canada has explained – refers to "the ability of EDC officials to assemble *better structured financial packages* . . . ."[14] All of these services – financial packages that are better structured, assistance that complements and goes beyond that provided by commercial banks, support that grants an edge – by definition offer something better than that available to Canadian exporters on the market. They therefore confer benefits.

28. The previous panel examining EDC support did ***not*** find, as Canada claims at paragraph 77 of its submission, that a determination of benefit "cannot be inferred or extrapolated from the generic statements of the EDC or its officials." A review of the paragraphs from the *Canada – Aircraft* report cited by Canada reveals no such principle. In any event, while Brazil's claim in the earlier case was that the statements I have just read suggested that EDC provides lower interest rates than are commercially available, its claims in this dispute are broader than that. These statements establish, at a minimum, that EDC – by its own admission – provides "services" that are better than what a recipient could get on the market.

29. With respect to export contingency, I refer again to Section 10(1) of the Export Development Act, which provides EDC's export mandate.[15]

30. Finally, Mr. Chairman, I would like also to note that the as36 e are Tcnais sucTc 4.0apmTj -19e3lndat86

however, that the non-transparent nature of EDC's operations makes it difficult for outsiders to obtain information about its transactions. The degree of non-transparency that characterizes EDC's operations can be appreciated by the fact that most of the information Brazil cited in its First Submission about EDC's operations was from third country sources, not Canadian sources.

33. It is significant, however, that Canada has not denied Brazil's allegations regarding EDC support for the Kendell and ASA transactions, also described in paragraphs 43 and 59 of Brazil's First Submission. The evidence discussed in Brazil's Submission indicates that EDC provided financial contributions for these transactions in the form of direct or indirect transfers of funds or liabilities. EDC support for these transactions was for periods ranging from [ ] years, which are beyond the 10-year maximum term identified in the OECD Arrangement.

34. The interest rates on these particular transactions are not disclosed in any public source of which Brazil is aware. However, the Panel should note that, in another proceeding, Canada has

Canada has notified no further action with regard to bringing Canada Account into compliance subsequent to adoption of the Article 21.5 Panel's ruling by the DSB. It should therefore be of no surprise, Mr. Chairman, that Canada Account continues to be inconsistent "as such" with Article 3.1(a) of the Subsidies Agreement. We have asked the Panel to make a finding confirming this fact.

40. Separately, Brazil makes the same arguments about the "as such" inconsistency with Article 3.1(a) of Canada Account loans and guarantees as it does with respect to EDC loans and guarantees. Canada Account provides financial contributions in the form of loans and guarantees,[18] which are direct or potential direct transfers of funds within the meaning of Article 1.1(a)(1) of the Subsidies Agreement.

41. Every time a loan guarantee is issued by the Canada Account, it enables the recipient to obtain funds on terms more favourable than it otherwise could obtain on the market. In Canada's own words, when describing a loan guarantee, "the lending bank establishes financing terms in the light of the risk of the [government guarantor], not the borrower."[19] In the case of the Canada Account, a guarantee would lead a lender to establish terms in light of the Government of Canada's AAA rating, not the lower rating of the aircraft purchaser. The recipient realizes a very real and significant benefit because of a Canada Account guarantee.

42. With respect to export contingency, paragraph 80 of Brazil's First Written Submission demonstrates that only export transactions are eligible for Canada Account support. The Panel in the earlier *Canada – Aircraft* dispute found that Canada Account was *de jure* contingent on export.[20] Canada has made no changes to Canada Account that would affect that finding.

43. We have demonstrated the three elements of a prohibited export subsidies claim. The Panel should therefore conclude that Canada Account loans and guarantees are prohibited export subsidies "as such."

IV. Canada Account "As Applied"

44. Brazil also challenges the way Canada Account is applied, which is illustrated by the Air Wisconsin transaction. The facts of Canada Account's participation in that transaction are described in Brazil's First Written Submission. Unfortunately, they were not provided by Canada to Brazil on 25 June 2001. In any event, through Canada Account, Canada is providing a financial contribution in the form of a loan (or the debt portion into a US leveraged lease) on terms that its Industry Minister described as follows:

> What we're doing here is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier.[21]

45. Canada does not contest that Canada Account support for the Air Wisconsin transaction confers a benefit, or that such support is contingent in law or in fact on export. Instead, it claims that its actions are justified under the "safe haven" included in the second paragraph of item (k) to the Illustrative List of Export Subsidies annexed to the Subsidies Agreement. Specifically, Canada claims

[18] EDC SUMMARY REPORT TO TREASURY BOARD ON -nt tha5awcon[illegible]

that it was "merely matching Brazil's offer in a manner consistent with the 'interest rates provisions' of the [OECD] Arrangement."[22]

46. The problem with this argument, as I said at the outset, is that there is no Brazilian offer for Canada to match. There is only an Embraer offer. The Arrangement permits matching only of officially supported credits, not privately offered credits. Further, even if official credits had been

Wisconsin transaction in particular. Indeed, Canada admits that if Air Wisconsin chooses to structure the transaction [ ], ". . . [W]ith respect to [ ] aircraft, the Government of Québec is providing a guarantee [ ]."[27] This guarantee is provided under Article 28(1) of the IQ Act. In addition, Canada does not deny that, in 1996, Investissement Québec "created a five-year $450-million programme to provide loan guarantees to Bombardier's customers," and that the provincial cabinet recently approved "another $76 million" for this purpose.[28]

53. As Canada notes in its First Submission, "the provision of such guarantees by a government

59. Canada's designation of part of its territory – in this case, Québec – as ineligible for the subsidy has the necessary effect of increasing the incentive of producers to export and the likelihood that they will do so because all of their home territory is not available to them. Canada seems to imply that, because nine of its 10 provinces remain eligible markets for the subsidized goods, this is somehow close enough to 10 out of 10. But if a Member may make one province ineligible, why not two? Why not three? Why not nine?

60. Would Canada agree to apply its position to Brazil's PROEX subsidy **if** Brazil were to make part of its domestic territory eligible for interest rate support for regional aircraft? Would Canada be willing to do so if Brazil were to designate a small village in the Amazon that did not have an air strip as the eligible domestic territory?

61. If not, how is the line to be drawn? The WTO dispute settlement process is ill-equipped to decide how much domestic territory must be made eligible for the subsidy in order to do away with an export designation. There is admittedly a large difference between a small village and an entire country except for a single province or state, but how is the line to be drawn?

62. Clearly, it cannot be drawn in any acceptable manner, and this demonstrates how Canada's position is subversive of the subsidy disciplines of the WTO. If eligibility of part, but not all, of a Member's territory for a subsidy is enough to remove export contingency, many small, partial domestic eligibility designations are likely to follow rapidly. Brazil maintains, therefore, that IQ guarantees are in law or in fact contingent on exports.

VI. Investissement Québec "As Applied"

63. In addition to its challenge against Investissement Québec "as such," Brazil also challenges Investissement Québec's application in regional aircraft transactions supporting the sale of aircraft by Bombardier to Air Wisconsin.

64. As I have already noted, IQ spokesman Jean Cyr has indicated that Investissement Québec established a five-year, $450 million fund to provide guarantees to Bombardiers' customers. Mr. Cyr also reported that when Bombardier approached the Québec government seeking further support for its sale to Air Wisconsin, in December 2000, approximately $150 million of the $450 million fund remained unused. In response to Bombardier's specific request for support, the provincial cabinet approved an additional $76 million to support the sale to Air Wisconsin. The result was that $226 million was made available to support the export sale to Air Wisconsin.

65. Canada has not denied that Investissement Québec provides guarantees. At paragraph 87 of its First Written Submission, Canada notes that Brazil has only referred to loan guarantees and has confirmed that loan guarantees are financial contributions for purposes of Article 1.1(a)(1)(i) of the SCM Agreement.

66. Canada has also not denied that Investissement Québec provided subsidies to support the sale to Air Wisconsin. In fact, at footnote 37 of its First Written Submission, Canada notes that if the [], the Government of Québec is providing a guarantee [ ] of each aircraft." This is not the only example of specific application of Investissement Québec support for Bombardier's export sales. A further example is discussed at paragraph 90 of Brazil's First Written Submission.

67. Canada has taken the position that the guarantees provided by Québec through Investissement Québec to support Bombardier's sales are not subsidies, on the basis that they confer no benefit, and are not export subsidies, because they are not made contingent on export. I will deal with each point separately.

68. With respect to benefit, as I have already noted, the guarantees provided by Investissement Québec are based on the credit rating of the Province of Québec, not the credit rating of the borrower. There is no question that these loan guarantees will provide a benefit.

69. Moreover, with respect to the Air Wisconsin transaction, Canada stated, at paragraph 46 of its First Written Submission, that its financing offer to Air Wisconsin was made to match what it assumed to be Brazil-supported below-market financing for Embraer aircraft. As Canada confirmed, in footnote 37, the Québec government support was included in this transaction. Therefore, it is clear that the Government of Québec was also providing support intended to match the assumed Brazil-supported, below-market financing. As I have already noted, there was no officially supported below market financing to match. The result is that the subsidy provided by Canada Account conferred a benefit and, likewise, the subsidy provided by Québec through Investissement Québec conferred a benefit.

70. With respect to export contingency, I have already addressed this issue generally. Investissement Québec guarantees are export subsidies because they are contingent on export. With respect to the Air Wisconsin transaction, the contingency on export is even more apparent. Mr. Cyr confirmed that the provincial cabinet only decided to approve additional funds after Bombardier "came to us and said they were negotiating this big deal with Air Wisconsin that would require" more than the remaining $150 million. Air Wisconsin is, of course, a US airline. Every Canadian regional jet manufactured in Québec, in fact, has been exported not only out of Québec, but out of Canada. The Government of Québec also knew that Bombardier was competing with Embraer for the contract and believed that Bombardier was competing with Brazil-supported, below-market financing. The additional funds requested by Bombardier were approved by the provincial government so that Bombardier could win the Air Wisconsin contract. Therefore, the subsidy provided to support Bombardier's sale to Air Wisconsin was clearly tied to exports and, therefore, was contingent on exports.

71. Finally, and still, with regard to IQ, Mr. Chairman, I have to admit I am a little bit confused. A moment ago I mentioned the statement made by IQ spokesman Mr. Cyr that, in 1996 the provincial investment fund created a five-year $450 million programme to provide loan guarantees to Bombardier's customers. Mr. Cyr then stated that, about $300 million of that fund had been used when Bombardier approached IQ on 20 December 2000 and "said they were negotiating this big deal with Air Wisconsin that would require" more than the remaining $150 million. This statement is contained in Brazil's Exhibit 9. Mr. Cyr's statement seems to be confirmed by a publication of 17 June 1995 stating that Brit Air, a purchaser of regional jet aircraft from Bombardier, obtained the assistance of Bombardier, of a French bank, and of the Société de Développement Industriel du Québec (SDI) to complete the financing.[30] The relevant text of the announcement, which we are distributing as an exhibit, reads in French: "Chaque Regional Jet coûte 20 million de dollars, une fois aménagé à l'intérieur. Compte tenu de son prix, Brit Air a obtenu l'assistance de la société Bombardier, celle d'une banque française, de même que celle de la Société de développement industriel du Québec (SDI) pour compléter le financement."

72. Yet, at paragraph 117 of Canada's Second Written Submission of 4 December 1998 in *Canada - Aircraft*, Canada stated that *none* of the guarantees or financing activities under the "export development" eligibility criterion of SDI (which became IQ in 1998) was related to the civil aircraft sector.[31] On the basis of that statement, the Panel in *Canada - Aircraft*, at paragraph 9.275, found that, "Brazil has failed to adduce any evidence of IQ assistance to the Canadian regional aircraft sector. Accordingly, there is no basis for a *prima facie* case that IQ assistance has been provided to

[30] Exhibit Bra-52.
[31] *Id.*

the regional aircraft industry."[32] Mr. Chairman, these statements seem contradictory to us. Brazil would appreciate it if Canada could clarify this apparent contradiction and inform the Panel whether IQ has ever, in fact, been used to assist the Canadian regional aircraft industry, both prior to 4 December 1998, and, of course, after that date.

VII. Conclusion

73. Mr. Chairman, for all of these reasons, Brazil requests the Panel to conclude that EDC, Canada Account, and IQ are, "as such" and "as applied," prohibited export subsidies. We will do our best to answer any questions you might have.

[32] *Id.*

7. In contrast, paragraph 24 of Brazil's 22 June response identifies which of those specific forms of "financial contributions" are not the focus of its claims. As stated in its request for establishment, Brazil's claims against EDC are limited to "financing, loan guarantees, or interest rate support" for the regional aircraft industry.

8. Third, at paragraph 24 of its oral statement on jurisdiction, Canada points to an alleged inconsistency between paragraph 92 of Brazil's First Written Submission, and paragraph 24 of Brazil's 22 June response. Paragraph 92 of Brazil's First Written Submission states that IQ provides loans, guarantees ("suretyship") and "'any other form of intervention provided for in its business plan.'" Paragraph 92 also states that all of these types of support constitute "financial contributions" under Article 1.1(a)(1) of the SCM Agreement. This is a factually accurate statement, and does not

aircraft industry *via* EDC, Canada Account and IQ during consultations with Brazil on 21 February 2001. Nor did Canada provide oral or written responses to the list of questions put to it by Brazil during consultations.[6] Canada's actions were contrary to the Appellate Body's requirement that parties be "fully forthcoming" and freely disclose facts relating to claims, "in consultations as well as in the more formal setting of panel proceedings."[7] Canada cannot decline to notify its measures, refuse to be responsive in consultations about those measures, and then object that Brazil's Canada'sactionswerecontrarytc5notle797.25C7i0-hesactioaus2actsrel4

ANNEX A-9

RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL FOLLOWING THE FIRST MEETING OF THE PANEL

(6 July 2001)

Questions to the Parties – 29 June 2001

THESE QUESTIONS ARE INTENDED TO FACILITATE THE WORK OF THE PANEL, AND DO NOT IN ANY WAY PREJUDGE THE PANEL'S FINDINGS ON THE MATTER BEFORE IT. NOR DO THEY PREJUDGE ANY RULINGS THAT MAY BE MADE BY THE PANEL REGARDING ITS JURISDICTION.

PLEASE NOTE THAT THE PANEL USES THE TERMS "AS SUCH" AND "AS APPLIED" BECAUSE THEY ARE USED BY THE PARTIES. THE PANEL'S USE OF THESE TERMS IS IN NO WAY INDICATIVE OF THE PANEL'S VIEWS ON THE IDENTITY OF THE SPECIFIC MEASURES AT ISSUE.

Questions for both Parties

1. What, if any, is the precedential effect of the findings of the *Canada – Aircraft* (DS70) Panel on this Panel's consideration of Brazil's claims regarding the Canada Account and EDC programmes as such? What, if any, is the precedential effect of the findings of the *Canada – Aircraft* (DS70) Panel on the matching provisions of the OECD Arrangement under item (k) of the Illustrative List of the SCM Agreement.

Panel reports do not have the effect of a legal precedent. Thus, the Panel in this case is fully entitled to consider Brazil's claims regarding the Canada Account and EDC programmes "as such." The Panel's jurisdiction and competence to review those programmes as such and make the appropriate findings are not, and could not be, affected by the fact that the same programmes were challenged as such in a previous case.

The Panel is entitled to, and in the view of Brazil should, consider the findings of the DS70 Panel with respect to Canada Account and EDC. The Panel may, of course, disagree with some of the findings in DS70. It may, on the other hand, determine the findings and the factual and legal conclusions made by the DS70 Panel useful for its analysis of Brazil's claims in these proceedings.

Similarly, with respect to the matching provisions of the OECD Arrangement under item (k), the Panel may, but does not necessarily have to agree with, the DS70 Panel's conclusions. In Brazil's

For a further discussion of issues relevant to this question, please see the response to Question 2 below.

2. Does this Panel have jurisdiction to review Brazil's claims regarding the Canada Account and EDC programmes as such? In particular, is the principle of *res judicata*, or a similar principle, applicable in this case, so as to preclude the Panel's consideration of issues previously ruled on by a Panel?

The Panel does have jurisdiction to review Brazil's claims regarding Canada Account and EDC as such. Neither the principle of *res judicata* nor any similar principle that might be applicable in this case precludes this Panel's consideration of issues that may have been previously ruled upon by another WTO panel. This is the case, even though the programmes – on the books – may not have changed since they were last reviewed by a WTO panel, for the following reasons.

In the DS70 proceedings the Panel did not rule that EDC was consistent with the SCM

measures with the provisions of the *SCM Agreement.*"[6] Brazil, in this case, is following the advice of the Appellate Body.

The new information and evidence Brazil has provided in this case allows it to make a *prima facie* case that not only certain of the Canada Account and EDC financing measures are inconsistent with the provisions of the SCM Agreement, but that the *modus operandi* of the programme as such is also inconsistent with the Agreement. The new evidence relates not only to specific transactions. It also relates to the *raison d'etre* of EDC in both its Canada Account and Corporate Account activities. That evidence shows that the very existence of these programmes – and, therefore, the programmes as such – is to provide export subsidies.

The new evidence is not limited to the Air Wisconsin transaction, although that transaction is a good example of the way the challenged programmes operate and of the interaction between EDC (Corporate Account) and EDC (Canada Account).[7] Canada's defences with respect to the Air Wisconsin transaction can be summarized as follows. When official government financing is provided, Canada "matches" such financing offered by other governments. When there is no official government financing, Canada operates through the market window and offers financing on terms available in the commercial marketplace. This is the way EDC operates the Canada Account and the Corporate Account. These operations are, in other words, the programmes "as such." Brazil

and IQ transactions identified in its first submission, or (4) on some combination of (1), (2) and (3)?

Brazil is requesting findings by the Panel on points (1), (2), and (3). Brazil is requesting that the Panel find the Canada Account, EDC and IQ programmes as such inconsistent with Canada's obligations under the SCM Agreement. Brazil is also requesting that the Panel find the Canada Account, EDC and IQ programmes inconsistent with Canada's obligations under the SCM Agreement as applied on the basis of evidence regarding specific transactions. Finally, Brazil is requesting that the Panel find the specific Canada Account, EDC and IQ transactions identified in its First Written Submission as breaching Canada's obligations under the SCM Agreement.

26. What is the distinction between a claim concerning (1) a measure "as such" and (2) a measure "as applied"? What is the relevance of individual transactions in addressing claims concerning (1) a measure "as such" and (2) a measure "as applied"?

A measure "as such" is inconsistent with a Member's obligations when it calls for action by the executive authority that is inconsistent with a Member's WTO obligations. A measure is inconsistent "as applied" when its application is inconsistent with the WTO obligations of a Member.[8] Individual transactions may serve to illustrate and prove that a measure is inconsistent "as such" because it envisions that the transactions in question be carried out in a manner inconsistent with the WTO. Individual transactions may also serve to illustrate and prove that a measure is inconsistent "as applied" because, even if it does not require that the transactions in question be carried out in a manner inconsistent with a Member's WTO obligations, it is applied in an inconsistent manner.

In this case, Brazil challenges EDC, Canada Account and IQ both "as such" and "as applied." Brazil has shown that individual transactions breach Canada's obligations under the SCM Agreement. This should be sufficient for a finding that the programmes are inconsistent "as applied."

In addition, however, individual transactions serve to illustrate that it is inherent in the design and the *modus operandi* of the three challenged Canadian programmes to operate in a manner that is inconsistent with the SCM Agreement.

27. Please identify the specific findings or recommendations, if any, that Brazil is requesting on the issue of whether or not Canada has implemented the findings and recommendations resulting from Brazil's recourse to Article 21.5 in the DS70 proceeding?

Brazil is requesting a ruling by the Panel that, *as a matter of fact*, Canada has done nothing since the adoption of the Report in the Article 21.5 DS70 proceedings to bring Canada Account in compliance with the SCM Agreement.

The Panel in the DS70 proceedings found that "Canada Account debt financing since 1 January 1995 for the export of Canadian regional aircraft constitutes export subsidies inconsistent with Article 3.1(a) and 3.2 of the SCM Agreement"[9] and concluded that "Canada shall withdraw [those] subsidies … within 90 days."[10] The Appellate Body affirmed.[11] The Article 21.5 Panel found that "the measures taken by Canada to comply with the DSB recommendation on the application of

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[8] *See United States – Denial of Most-Favoured Nation Treatment as to Non-Rubber Footwear from Brazil*, BISD 39S/128 (19 June 1992), para. 6.13, *citing United States – Taxes on Petroleum and Certain Imported Substances ("Superfund Taxes")* BISD 34S/136 (17 June 1987) *and EEC – Regulation on Imports of Parts and Components*, BISD 37S/132 (16 May 1990).

[9] WT/DS70/R, para. 10.1(b).

[10] *Id*., para. 10.4.

[11] WT/DS70/AB/R, paras. 220 and 221.

the Canada Account programme are not sufficient to ensure that future Canada Account transactions in the Canadian regional aircraft sector will be in conformity with the interest rate provisions of the *OECD Arrangement*, and are therefore not sufficient to ensure that such Canada Account transactions will not be prohibited export subsidies."[12] Canada did not appeal that finding.

Brazil is not asking this Panel to review the findings of the DS70 Article 21.5 Panel or to uphold or confirm the findings of that Panel. Similarly, Brazil is not asking this Panel to draw conclusions as to what Canada should have done. Brazil simply is requesting a factual finding that, since the adoption of the DS70 Article 21.5 Report, Canada has not made any changes in Canada Account. It is Brazil's understanding that Canada does not dispute this as a matter of fact. Indeed, in response to a question from the Panel during the second day of the Panel's first meeting, Canada confirmed that it had made no changes in the statutes and regulations that constitute the legal basis of EDC (Corporate Account or Canada Account).

28. The United States argues that the distinction between discretionary and mandatory legislation has been described by a WTO Panel as a "well established" principle (para. 2 of the US oral statement). Does Brazil consider that the distinction between discretionary and mandatory legislation is "well established"? If so, is the distinction applicable in this case?

Brazil agrees with the United States that the distinction between discretionary ("as applied") and mandatory ("as such") legislation is an established principle of GATT and WTO jurisprudence. Brazil does not believe, however, that the principle in those precise terms is applicable in this case to the Canadian programmes challenged by Brazil.

The recent Report in *United States – Measures Treating Export Restraints as Subsidies* noted that "a number of Panels, in disputes concerning the consistency of a legislation, have *not* considered the mandatory/discretionary question in the abstract and as a necessary threshold issue. Rather, the Panels in those cases first resolved any controversy as to the requirements of the GATT/WTO obligations at issue, and only then considered *in light of those findings* whether the defending party had demonstrated adequately that it had sufficient discretion to conform with those rules. That is, the mandatory/discretionary distinction was applied *in a given substantive context.*"[13]

The "substantive context" of EDC is that of an Export Credit Agency ("ECA"). ECAs exist to subsidize exports. This is their purpose. Their "subsidies … enable the country's industries to

The participants in the recently-concluded OECD Arrangement, most if not all of which were potential signatories to the plurilateral Tokyo Round Code, were faced with the fact that actions by their respective ECAs permitted by the newly-negotiated Arrangement would, nonetheless, be inconsistent with their obligations under the Code. In the words of Gary Hufbauer, one of the Tokyo Round negotiators, "many countries were unwilling to condemn as export subsidies those practices condoned in the OECD."

meet the burden of proof of its affirmative defense and show that the programmes fall within the scope of the exception of item (k). Canada has failed to do so.

A classic example of a prohibited subsidy – and a good illustration of Brazil's argument – are export loan guarantees. Export loan guarantees provided by government financing institutions or ECAs always confer a benefit because they confer the government's superior credit rating to a private party. If the government's credit rating were not superior, there would be little point to the guarantee. As Brazil pointed out in its Oral Statement, EDC loan guarantees allow the recipient to obtain funds on terms more favourable than it otherwise could obtain on the market.[21]

IQ is somewhat different in the sense that it covers various activities, including investment promotion in Quebec, supporting business development in Quebec, etc. One aspect of the programme, however, calls for the provision of loan and equity guarantees. With respect to that particular component of IQ, the programme operates as an ECA, and, for the reasons described above, is inconsistent with the SCM Agreement "as such."

30. Please respond to paragraph 52 of Canada's 18 June 2001 preliminary submission regarding the jurisdiction of the Panel.

In paragraph 52 of its 18 June 2001 preliminary submission, Canada states that Brazil challenges not only EDC financial contributions defined in Article 1.1(a)(1)(i) but also an unlimited range of financial services defined in Article 1.1(a)(1)(iii) of the SCM Agreement. Canada asserts that, because Brazil did not specify in its claim which services it challenged and did not identify the specific provisions of Article 1 on which it relied, Brazil's claim is contrary to Article 6.2 DSU. Canada's argument should be rejected.

Brazil notes that Article 1 of the SCM Agreement does not deal with Canada's *obligations* under the SCM Agreement; rather, it simply *defines* the term "subsidy." A subsidy as defined in Article 1 is prohibited by Article 3 if it is conditioned on export. The *obligation* is in Article 3.

In *Korea – Dairy*, the Appellate Body found that the EC's request for the establishment of a Panel was adequate even though it simply listed articles that contained multiple obligations.[22] For example, in that case the EC simply cited Article XIX, and, as the Appellate Body noted, "Article XIX of the GATT 1994 has three sections and a total of five paragraphs, each of which has at least one distinct obligation."[23] Nonetheless, the Appellate Body found that Korea was not prejudiced by this broad request.[24]

Here, Brazil's request for the establishment of the Panel is far more specific than the EC request that the Appellate Body found adequate in *Korea – Dairy*. Brazil's request specified that certain "export credits" were "export subsidies" within the meaning of Articles 1 and 3. Of necessity, this description included paragraph 1 of Article 1, since that paragraph defines subsidies. It also, of necessity, included subparagraphs (a) and (b) of paragraph 1, because those sub-paragraphs define the constituent elements of a subsidy. It also, of necessity, included sub-sub-paragraph (1) of sub-paragraph (a) because that defines "financial contribution" and the term "export credits" could only fit in that sub-sub-paragraph. Certainly Canada cannot plausibly suggest that it believed sub-sub-paragraph (2) of sub-paragraph (a), dealing with income and price support in the sense of Article XVI

[21] For a more detailed discussion, Brazil refers the Panel to paras. 21-25 of its Oral Statement of 27 June 2001.

[22] *Korea – Definitive Safeguard Measure on Imports of Certain Dairy Products*, WT/DS98/AB/R (Adopted 12 January 2000), para. 129.

[23] *Id*.

[24] *Id*., para. 131.

of GATT 1994, had anything to do with "export credits." In this regard, Brazil would note that it is Canada, not Brazil, that is a Participant on the *OECD Arrangement on Guidelines for Officially Supported Export Credits*. Presumably, therefore, Canada knows what the term "export credits" means.

Similarly, and although this argument was not raised by Canada or the Third Parties, Brazil notes that the reference to "export subsidies" within the meaning of Article 3 of necessity encompassed both paragraphs of that Article – there are only two, and the second consists of a single sentence with no subparagraphs. Of necessity it encompassed only sub-paragraph (a) of paragraph 1 as that is the subparagraph dealing with export subsidies. The only other subparagraph, (b), concerns a preference for the use of domestic over imported goods, and is not related in any way to "export," or "export credits," or "export subsidies."

The fact that Brazil did not specify in its claim which financial services it challenges does not violate Article 6.2 DSU. In its request for establishment, Brazil's *claim* is that the three Canadian programmes at issue are prohibited under Article 3 of the SCM Agreement. Under Article 1, the precise way in which the Canadian programmes grant financial contributions, and the way in which they confer benefits, are *arguments* in support of that claim. In *European Communities – Bananas*,

consultations about those measures, and then object that Brazil's claims regarding those measures are so broad as to prejudice Canada's ability to defend itself.

31. Please respond to paragraph 14 of Canada's oral statement of 27 June 2001 (on substance).

In paragraph 14 of its oral statement, Canada raises three possibilities with respect to the terms of Embraer's offers to Air Wisconsin. Brazil will address them one by one.

First, the Government of Brazil did not and has not made a commitment to Embraer, formal or informal, to provide support in connection with the Air Wisconsin offer. Embraer could not have made the offers to Air Wisconsin with the "understanding" that the government would provide the necessary support; there can be no such understanding before the completion of the approval process, much less before the initiation of the process. Brazil cannot say whether Embraer made the offers "in the expectation" that the government would provide support. Even assuming that was the case, however, the authorities in charge of reviewing and approving applications of support would not have based their decision on Embraer's expectations, but on the criteria specified in the appropriate legal instruments.

Second, Brazil is not in a position to discuss the accuracy of the representations made by Air Wisconsin officials to [] the Canadian officials. In the absence of an opportunity to present witnesses for cross examination, the Panel's task will be to evaluate the evidence as it is. Brazil would think that its own statement would have stronger evidentiary value than that [].

Third, Canada finds it incredible that Embraer would have been able to arrange commercial financing and find sources of commercial credit that would provide terms such as those offered to Air Wisconsin. Canada's views on this matter are irrelevant. Canada is essentially questioning Embraer's commercial and marketing strategy, which Canada is neither entitled nor qualified to do.

Companies have been known to offer aggressive pricing to win market share. The Air Wisconsin transaction []. One can speculate more what Embraer intended to do, but the fact remains that Brazil offered no government support to Embraer for the Air Wisconsin transaction.

32. According to the unofficial translation of Embraer's financing offer to Air Wisconsin, "EMBRAER made two financing offers, neither of them involving any support from the Brazilian Government". Does this assertion mean that, in respect of the proposed transaction with Air Wisconsin, there was no intention on the part of Embraer to seek/arrange any support from the Brazilian Government at any time, or to seek/arrange any support under Brazil's PROEX programme?

The same unofficial translation also states, for both offers, that "EMBRAER committed itself to identifying and structuring the financing by means of credit lines obtained in the commercial financial market". Please explain how the English phrase "<u>commercial</u> financial market" may be derived from the Portuguese phrase "mercado financeiro".

As discussed in the response to Question 31, Brazil cannot say what the intention on the part of Embraer was when the offers to Air Wisconsin were made. In response to Question 33, Brazil has provided [] as Exhibit Bra-56. [].

Brazil can definitively state that the Brazilian Government did not provide support to Embraer or Air Wisconsin for this transaction. Support from the Brazilian Government would have required Embraer to go through the requisite process, and would have been approved only if the criteria

specified in the applicable legal instruments had been met. No request was made to initiate that process.

Brazil would note that Embraer extended two offers to Air Wisconsin. After Embraer made its first offer, it was told that the offer was not competitive. Embraer then improved the offer (including the doubling of its first loss deficiency guarantee). Apparently, even Embraer's improved offer was not sufficient to compete with the offer made by Bombardier and Canada.

As to the translation, there was a mistake. The proper translation of the Portuguese phrase "mercado financeiro" in English is "financial market."

33. Was Embraer's second offer to Air Wisconsin made in writing? If so, please provide a copy of that second offer.

Brazil has provided as Exhibit Bra-56 [].[31]

34. Does Brazil consider that Canada's offer to Air Wisconsin was more favourable than the second EMBRAER offer to Air Wisconsin? If so, please explain precisely why.

Yes, Brazil believes that Canada's offer to Air Wisconsin was more favourable than the second Embraer offer. The offers were clearly not identical, and Air Wisconsin just as clearly accepted Bombardier's offer with Canadian government support. It would not have done so had it not found the offer more favourable. Neither Brazil nor, in Brazil's view, the Panel, is able to establish the contrary.

Finding itself with no basis for its claim that Brazil supported Embraer in the Air Wisconsin transaction, Canada falls back on a "no-benefit, no-subsidy" theory. It notes the statement by an Air

Brazil therefore conducted a Westlaw search of the financing activities of these two banks with respect to aircraft. That search shows no indication that the market supports terms of financing in the range alleged by Canada.[34]

Practically all financing done by these banks was for sales of large aircraft. In the predominant majority of those cases, the term of financing does not exceed 12 years – the upper limit specified in the OECD Arrangement for large aircraft. The only two exceptions, where the term of financing exceeded 12 years, are a credit to FedEx to be used in aircraft leasing (Bank of America) and an 18 year financing to LanChile for the purchase of Airbus (Citibank with several major European banks).

Further, contrary to Canada's implied suggestion that Citibank and Bank of America were among those that financed Bombardier transactions, the search showed no such financing. The only mention of Bombardier concerns a E66 million contribution by Citibank toward a credit facility for Bombardier to refinance existing debt and for general corporate purposes.

The search found financing for only one regional jet transaction in which the term was specified. This was for lease sale of two ERJ-145s to LOT Polish Airlines financed for a period of 10 years.

36.

Under the Arrangement's rules, a Participant wishing to initiate a non-conforming offer or match another Participant's non-conforming offer is required to observe strict notification and waiting period requirements, both *vis-à-vis* all Participants and the specific Participant who made the initial non-conforming offer.[40] When it comes to matching, Participants therefore have significant information about what any other Participant intends to do, based on the following rules:

? A Participant must notify all other Participants if it wishes to initiate a non-conforming offer.[41] The initiating Participant must then respect certain waiting periods before going ahead with its non-conforming offer.

? A Participant intending to identically match another Participant's notified non-conforming offer, the matching Participant may proceed after observing a waiting period. But if the match is non-identical, the matching Participant must notify all Participants and respect additional waiting periods.[42]

? If a Participant intends to identically match another Participant's non-notified, non-conforming offer, it must give notice to the latter and observe certain waiting periods. But if the match is non-identical, the matching Participant must also notify all Participants and respect additional waiting periods.[43]

When non-participants are involved, however, the picture changes. If a Participant intends to match a non-participant's non-conforming offer, it need only notify other Participants and respect certain waiting periods. The non-participant receives no notice of the Participant's intent to match, or of the match itself.

The rather obvious differential treatment of Participants and non-participants concerned the Article 21.5 Panel in *Canada – Aircraft*.[44] Canada, the EC and the US all recognize this problem, although each offers a different solution.[45] This lack of agreement – even among those WTO Members who are also Participants in the Arrangement – illustrates the extent to which permitting recourse to matching would undermine "clarity and certainty concerning what the (SCM Agreement) rules are and how to comply with them."[46]

In addition, the various interpretations of how "matching" applies, offered by Canada, the EC and the US, raise serious questions of conformity with the most-favoured-nation requirements of Article I of GATT 1994. The inequitable notification requirements that would be imported into the SCM Agreement under the interpretation urged by Canada, the EC and the US would constitute a rule or formality in connection with exportation, and would accord an advantage, favour, privilege or

Agreement is irrelevant; any interpretation of item (k) that would require more favourable treatment for some WTO Members would ensure a violation of Article I of GATT 1994.

Moreover, Canada's suggestion that the absence of an obligation to provide notifications somehow compensates for the fact that non-participants do not themselves receive the Participants' notifications is inapposite. Such "counterbalancing" of less favourable treatment in one area with allegedly more favourable treatment in another does not cure an Article I violation, as discussed by

ANNEX A-10

SECOND WRITTEN SUBMISSION OF BRAZIL

(13 July 2001)

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I. INTRODUCTION

1. This submission is Brazil's second written submission in this proceeding, containing Brazil's further arguments as to why direct financing, loan guarantees and interest rate support provided by Canada through the Export Development Corporation's ("EDC") Corporate and Canada Accounts, and Investissement Québec ("IQ"), constitute prohibited export subsidies within the meaning of Articles 1 and 3 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

7. To the extent that Canada's 6 July 2001 responses to the Panel's questions have not been addressed elsewhere in this submission, Brazil provides brief comments in Section VI. Brazil notes, however, that due to logistical difficulties faced by Canada, the exhibits to Canada's responses to the Panel's questions were not received by the responsible Brazilian officials in Geneva until Tuesday, 10 July 2001, only three days before the due date for this submission. Accordingly, Brazil has not had sufficient time to review the materials submitted by Canada in detail and is not yet prepared to comment fully on those materials. Brazil will make additional comments on Canada's responses to the Panel's questions in its statement to the second meeting of the Panel.

II. JURISDICTIONAL ISSUES

A. Brazil's Panel Request Satisfies the Requirements of Article 6.2 of the DSU

8. Canada has argued that Brazil's request for the establishment of a panel did not satisfy the requirements of Article 6.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). Brazil believes that its submissions on this issue on 22 June 2001 and 28 June 2001 respond fully to Canada's arguments, and therefore Brazil will not re-state the points made therein. However, Brazil makes the following points in response to the arguments made by Canada on jurisdiction in its response to the Panel's questions.

9. First, both Brazil's request for consultations and its request for the establishment of a Panel specifically refer to export credits and guarantees provided by Canada, by means of the Export Development Corporation, the Canada Account, and the Province of Québec, to the regional aircraft industry. In its response to the Panel's Question 5, Canada disputed that Brazil's request was limited to the regional aircraft industry, stating that certain of the indented and numbered paragraphs of Brazil's request for a Panel did not contain the "important qualifier 'for the regional aircraft industry.'" However, the very first sentence of the first paragraph of the panel request refers to the regional aircraft industry. The notion that Canada, reading further down the request, was unclear as to what industry was at issue in this dispute simply defies belief.[1] Nothing in Canada's submissions on the issue of jurisdiction provide any reasonable doubt that Brazil properly identified, and Canada was fully aware, that this dispute involved export credits to the regional aircraft industry.

10. It is also beyond doubt that Brazil's request involved three Canadian measures – EDC, Canada Account, and Province of Québec aid through Investissement Québec. Brazil has never referred to or discussed other measures, and Canada, in its response to the Panel's Question 5, appears to accept that Brazil's request identified Canada Account, EDC, and IQ as the measures at issue, albeit, in Canada's view, in "general and imprecise language."[2]

11. Second, Brazil has challenged these three programmes as subsidies within the meaning of Article 1 of the SCM Agreement that are contingent, in law or in fact, on export and are therefore prohibited within the meaning of Article 3 of the SCM Agreement. Canada has not alleged that Brazil is seeking to proceed based on articles of the SCM Agreement not identified in the request for a Panel.

12. Canada has suggested that Brazil's request was not sufficiently specific in that it did not list separately Article 1.1(a)(1)(i) of the SCM Agreement.[3] However, the Appellate Body has stated that a

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[1] Both the request for consultations and the request for establishment of a panel use the heading *Canada – Export Credits and Loan Guarantees for Regional Aircraft.* Canada has previously argued that the title given to the case is not relevant to the clarity of the panel request. However, had Brazil considered that the title given to the dispute unduly narrowed its claim, it would surely have pursued the matter with the Secretariat before submitting its request for the establishment of a panel.

[2] Canada's Answers to the Panel's Questions, 6 July 2001, page 5.

[3] Oral Statement of Canada on Jurisdictional Issues, 27 June 2001, para. 22.

reference to an article of a covered agreement in a panel request incorporates a claim of inconsistency with the subheadings of that article:

> [A]s the request for the establishment of a panel of the European Communities included a claim of inconsistency with Article 23, a claim of inconsistency with Article 23.2(a) is within the Panel's terms of reference.[4]

Brazil's panel request referred to the three challenged measures as violating Articles 1 and 3 of the SCM Agreement. In this respect, Brazil's request is comparable to that of Canada in *United States – Measures Treating Exports Restraints As Subsidies*, in which Canada's request claimed simply that certain US measures violated Article 1.1 of the SCM Agreement, but Canada's first written submission elaborated that the challenged measures treated exports restraints in a manner contrary to several subheadings of Article 1.1, including Articles 1.1(a)(1)(i)-(iv).[5]

13. Third, Brazil has specifically challenged export credits in the form of financing, guarantees, and interest rate support offered through these programmes. Brazil has not challenged any other operations of these programmes. While there may be issues in the course of these proceedings as to precisely how Canada provides financing, guarantees or interest rate support under these programmes, these are factual issues to be resolved in the course of the proceedings, and do not create jurisdictional issues or introduce any lack of clarity in Brazil's panel request.

14. Contrary to Canada's claims that Brazil has sought to "cure" alleged deficiencies in its panel request, Brazil's repeated descriptions of the scope of its panel request – financing, guarantees, and interest rate support provided by EDC, Canada Account, and Investissement Québec to the regional aircraft industry – have simply repeated *verbatim* the language of the panel request and explained how that language is clear, specific, and fully understood by Canada.

15. Nevertheless, it appears that Canada is unwilling to take "yes" for an answer on this issue. No matter how often Brazil explains that its request is as straightforward as described above, Canada continues to try to sow confusion. Canada's responses to the Panel's questions contain a perfect illustration of Canada's tactics and the resultant difficulties faced by Brazil in this respect. In Brazil's First Written Submission, Brazil stated its understanding that EDC provided guarantees to Comair. In response, Canada stated in its First Written Submission that EDC did *not* 15 Canada st Brazil 'u– h72zil in thist TD -09thi

jurisdictional issues regarding descriptions of how these measures operate.[6] These alleged inconsistencies all relate to the details of the operations of the challenged measures. Like the issue of whether or how EDC supported the Comair transaction, the alleged inconsistencies are simply factual

22. Canada's position in this case is diametrically opposed to the position it took in *United States – Exports Restraints*. In that case, the United States argued that Canada's request for a panel failed to satisfy the requirements of Article 6.2 of the DSU because Canada failed to make clear whether its challenge to the US measures was "as such" or "as applied." The United States also objected to the vagueness of Canada's identification of the US "practices" at issue.[9] In response, Canada argued that the United States in effect claimed that because its measures were not mandatory, they were not properly before the Panel and should be dismissed. In Canada's view, however, the question whether a measure was mandatory or discretionary "is an issue that addresses whether that measure as such violates the GATT provisions invoked, not whether a panel has jurisdiction to hear a particular matter."[10] According to the Panel, Canada characterized the US requests for a preliminary ruling as an effort "to distract this Panel from its true task: resolving the dispute between Canada and the United States."[11] The Panel agreed with Canada, and declined to make a preliminary ruling on the ground that the Article 6.2 issues raised by the United States went to the substance of Canada's claims, and therefore were properly addressed as part of the substantive analysis of the claims.[12]

23. The position taken by Canada, and indeed the Panel, in *United States – Exports Restraints* applies with equal force in this case. The question whether Canada's measures constitute "as such" or "as applied" violations of the SCM Agreement goes to the essence of the substantive issues that must be interpreted by the Panel. Resolution of these issues will depend on the Panel's analysis of the factual evidence before it regarding the nature and operation of the measures.[13] As Canada put it in *United States – Exports Restraints*, the Panel should not be distracted from that analysis.[14]

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and imprecise." Moreover, Canada's position regarding the relevance of prejudice appears to contradict the position it took in *United States – Exports Restraints*, in which Canada opposed the US Article 6.2 claim on the ground that the United States had not been prejudiced because it was able to respond fully to Canada's claims.[16]

26. Finally, Canada alleges that its due process rights have been violated by the alleged lack of clarity or specificity in Brazil's request for the establishment of a panel. Brazil notes, however, that Canada has failed to provide any evidence that its ability to defend itself before this Panel has actually been delayed, complicated, or otherwise frustrated by this alleged lack of clarity.

27. In contrast, Canada's actions thus far have caused serious practical difficulties for Brazil. First, as Brazil has previously explained, Canada failed to provide substantive responses to Brazil's questions during consultations. The Appellate Body in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* stated that the due process demands of the DSU make it especially necessary that "facts must be disclosed freely" during consultations.[17] The Appellate Body recognized that "the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings."[18] To the extent that Canada feels that a perceived lack of clarity in Brazil's panel request has caused confusion as to the matters at issue – and Brazil strenuously disputes Canada's claim that it has suffered any such prejudice – Canada's failure to respond fully during consultations "did much" to shape Brazil's panel request.

28. Moreover, as the Panel is aware, Canada chose not to share its response to the P

30. In arguing that *res judicata*

III.

second paragraph of item (k).[33] Export credits provided by ECAs are export subsidies, the negotiators recognized, but they will not be considered prohibited export subsidies so long as they comply with the interest rate provisions of the Arrangement. If an ECA is not covered by the safe haven of item (k), it is providing a prohibited subsidy "as such" because providing export subsidies, as the Tokyo Round negotiators realized, is inherent in the very existence and functioning of an ECA. That is, again, why they created the second paragraph of item (k) in the first place.

46. Brazil's arguments that EDC support *via* the Corporate and Canada Accounts constitutes export subsidies "as such" must be viewed in that context. EDC, whether through its Canada Account or its Corporate Account operations, constitutes a measure that is indeed designed "as such" to provide export subsidies. Like other ECAs, EDC does not pay income taxes, does not pay dividends, and borrows on the credit of the Government of Canada.[34] The OECD Arrangement was meant to limit the extent to which these advantages could be abused.

47. Brazil is not saying, as Canada argues at paragraph 37 of its First Written Submission, "that because EDC is a government entity and as such does not pay income taxes, *any* financing by it constitutes a subsidy." Brazil's argument is that not paying taxes is illustrative of, and an essential prerequisite to, an ECA's capability to perform its normal mission – to provide export subsidies. As noted by former US Treasury Secretary Lawrence Summers:

> . . . Market Window institutions either directly, or potentially, contravene [OECD] Arrangement rules because they are controlled and implicitly subsidized by the state. Thus, Market Window institutions operate with an unfair competitive advantage because they benefit from special government concessions including guarantees by the state that enable them to raise funds at a lower cost than their private sector competitors, and because they are exempted from certain taxes and dividend payments. At the same time they act like official export credit agencies in restricting financing to national exporters.[35]

48. Brazil's claims encompass different forms of EDC financial contributions provided *via* the Corporate and Canada Accounts – guarantees, loans and financial services. The advantages EDC wields as a government ECA mean that when it provides these financial contributions, it confers benefits "as such." That is the very reason the OECD Arrangement was adopted – to control the way in which those benefits could be conferred. Simply saying that an ECA operates "on commercial principles" does not erase the advantages addressed by Secretary Summers, or the importance of the OECD Arrangement's rules to limit potential abuse. In this context, the market window standard outlined by Canada does not turn a mandatory measure into a discretionary one.

2. Specific Examples Illustrate that EDC Is an Export Credit Agency and As Such Requires the Provision of Subsidies Contingent Upon Export

49. Specific types of financial contributions challenged by Brazil illustrate the extent to which EDC confers benefits "as such." These are described below.

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[33] JOHN E. RAY, MANAGING OFFICIAL EXPORT CREDITS – THE QUEST FOR A GLOBAL REGIME, Institute for International Economics (1995), pgs. 36-38 (Exhibit Bra-54).

[34] Export Development Corporation 1999-2000 Reference Guide, pg. 9 (Exhibit Bra-23).

[35] Summers speech, pg. 3 (Exhibit Bra-29).

(a) Loan Guarantees

50. Loan guarantees provided by EDC's Corporate and Canada Accounts confer benefits by according "terms more favourable than those available to the recipient on the market."[36] As Canada has noted, where there is a government loan guarantee, "the lending bank establishes financing terms in the light of the risk of the . . . Government, not the borrower."[37] Similarly, EDC's Resolution Respecting Minimum Lending Yields, submitted by Canada as Exhibit Cda-47, provides that "where financing is to be secured by a guarantee, the credit rating of the guarantor shall be used . . . ."

51. EDC, as an agent of the Government of Canada, enjoys a credit rating of AAA from Standard & Poors.

goes beyond that provided by commercial banks, support that grants an edge – by definition offer something better than that available to Canadian exporters on the market. They therefore confer benefits.

55. As noted in paragraph 28 of Brazil's Oral Statement, the *Canada – Aircraft* Panel did not find, as Canada claims, that a determination of benefit "cannot be inferred or extrapolated from the generic statements of the EDC or its officials."[45] That Panel found that evidence provided by Brazil, including some statements by officials, did not establish that EDC provides lower interest rates than are commercially available. In this dispute, Brazil's claim is different and in fact broader; it is that these statements establish that EDC provides "services" that are better than what a recipient could get on the market. Canada's argument should therefore be rejected.

56. The European Communities' ("EC") suggestion that "services" can only be "financial contributions" if they are offered "for less than full consideration" or if they "involve a cost to the government" must also be rejected.[46] This argument improperly collapses the "financial contribution" and "benefit" elements of a prohibited export subsidies claim.[47]

57. Moreover, even if directed to the "benefit" element of a prohibited export subsidies claim, the EC's argument harkens back to the so-called "cost to government" interpretation, which was rejected by the Appellate Body in the earlier *Canada – Aircraft* case.[48] A "benefit" is conferred when a recipient gets a financial contribution on terms more favourable than it could receive on the market. The evidence cited by Brazil demonstrates that EDC provides services – financial packages that are

64. A good analogy is Article 27 of the SCM Agreement. It contains a temporary, eight-year exception from Article 3 of the SCM Agreement for developing countries meeting certain conditions. It is a matter of affirmative defence. The availability of the defence does not change the character of the export subsidy; it simply makes the prohibition temporarily inapplicable. Likewise, item (k), second paragraph, provides a safe haven for qualifying export credits without regard to whether they are "mandatory" or "discretionary."

B. EDC's Corporate and Canada Accounts "As Applied"

65. In its First Written Submission, Brazil identified five regional aircraft transactions demonstrating that as applied, EDC's Corporate and Canada Accounts provide prohibited export subsidies.[55] Because one of those transactions – Air Wisconsin – involves Canadian resort to the "safe haven" of item (k), Brazil will rebut Canada's arguments with respect to that transaction in a separate section of this submission.

66. Of the four remaining customers identified by Brazil, Canada asserted that neither Midway nor Comair received EDC support. Specifically, Canada says EDC's Corporate Account did not participate in the Midway transaction.[56] In Canada's 6 July response to Question 14 from the Panel, Brazil now learns that support for the Midway transaction came from IQ. This is further evidence of how Canada's tactic of "stonewalling" in consultations has denied Brazil the due process to which it is entitled. Brazil will address IQ support for the Midway transaction in Section V below.

67. Canada also stated that EDC's Corporate Account did not provide loan guarantees for the Comair transaction.[57] As noted above, however, Canada does not deny the evidence submitted by Brazil[58] that the Comair transaction involved either EDC Corporate Account support in a form other than guarantees, or guarantees from some other instrumentality of the Canadian government (one example might be the Canada Account). Brazil notes, for example, Canada's statements, in paragraphs 3-4 of its 6 July response to Question 11 from the Panel, that pricing for ASA [ ] on "EDC pricing offered to Comair." Given Canada's failure to be fully forthcoming with information regarding the Comair and Midway transactions, Brazil requests that the Panel specifically ask Canada whether a government guarantee or other support was provided to Comair or Midway, and through which Canadian government agency it was provided.

68. Moreover, Brazil asks the Panel to recall Canada's admission, in another proceeding, that the EDC Corporate Account has extended fixed interest-rate export credits at interest rates below the OECD Arrangement's minimum interest rate, the CIRR.[59] Brazil discussed these transactions at paragraph 56 of its First Written Submission, and again at paragraphs 34-35 of its Oral Statement. These financial contributions confer a benefit. The Panel will recall the Appellate Body's statement in *Brazil – Aircraft* that a net interest rate to a borrower below the relevant CIRR is "positive evidence" that the rate secures a "material advantage," under item (k) of Annex I to the Subsidies Agreement.[60] As discussed at paragraphs 51-54 of Brazil's First Submission, export support that confers a "material advantage" will always confer a benefit, since item (k) and the "material advantage" standard only become an issue when a subsidy, including a benefit, has already been demonstrated.

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[55] Brazilian First Written Submission, paras. 43, 59.

[56] Canadian First Written Submission, para. 64.

[57] Canadian First Written Submission, para. 65.

[58] Brazilian First Written Submission, paras. 43, 59.

[59] WT/DS46/RW, para. 6.99 (The Panel was "struck by Canada's assertion that export credits provided by EDC through the 'market window,' even at interest rates below CIRR, were nevertheless 'commercial' export credits that did not confer a benefit within the meaning of Article 1.").

[60] WT/DS46/AB/R, para. 182.

69. Canada has not identified the specific transactions involved, except to state that they occurred sometime after 1 January 1998.[61] Because rates below CIRR constitute "positive evidence" of material advantage and benefit, Brazil requests that the Panel specifically ask Canada for details regarding these transactions.

70. Brazil will now turn to the two remaining customers discussed in its First Written Submission, ASA and Kendell. Canada provided information regarding the terms of EDC Corporate Account support for sales to those customers with its 6 July responses to Question 11 from the Panel.

1. ASA

71. ASA Holdings, Inc. and Atlantic Southeast Airlines (collectively "ASA") described certain of the terms underlying its purchase of Canadian regional aircraft in filings with the US Securities and Exchange Commission ("US SEC"). Brazil discussed those terms in paragraphs 43 and 59 of its First Written Submission, and in Exhibits Bra-36 through Bra-38. Canada has provided further details regarding EDC support in its 6 July response to Question 11 from the Panel. EDC financing for sales to ASA conferred and continues to confer a benefit, within the meaning of Article 1.1(b) of the SCM Agreement, in two ways.

72. First, as noted in the US SEC documents included in Exhibits Bra-36 through Bra-38, EDC financing support exceeded the 10-year maximum repayment term included in the OECD Arrangement for regional aircraft. As discussed in paragraphs 50-54 of its First Written Submission, terms beyond the 10-year maximum constitute "positive evidence" of a benefit, within the meaning of Article 1.1(b) of the SCM Agreement.

73.

75. Brazil made no attempt, as the Panel said, because the opaque nature of EDC and its operations prevented Brazil from obtaining the relevant information. Now, Canada's answer to Question 11 provides relevant information. That answer makes clear that not only in the ASA transaction, but even in all other transactions where its [] is achieved, Canada, in fact, provides below market financing. Canada states, at paragraph 4 of its response to Question 11, that it provided financing at [] to ASA, [] basis points below its []. The OECD Commercial Interest Reference Rate, it will be recalled, is 100 basis points above the seven-year US Treasury Bill. As of the writing of this submission, T-Bill plus []. But the CIRR, by itself, does *not* include a risk premium. Thus, while CIRR alone may be sufficient to secure the "safe haven" in the second paragraph of item (k), it is not enough to avoid conferring a benefit. []66 The prime rate, however, is available only to borrowers with the best credit ratings, and even Canada does not argue that regional carriers are candidates for the prime rate. Thus, EDC's [] would confer a benefit on a borrower worthy of the prime rate, to say nothing of a regional airline, or especially a regional airline like ASA that gets an [] the already subsidized rate. Indeed, Canada's Exhibit Cda-47, which is EDC's "[]" suggests that EDC's [].

2. Kendell

76. Press reports described certain of the terms involved in EDC support for the sale of Canadian regional aircraft to Kendell Airlines. Brazil discussed those terms in paragraphs 43 and 59 of its First Written Submission, and in Exhibits Bra-34 through Bra-35. Canada has provided further details

Minister Tobin's press conference until now, Canada has produced no evidence to the contrary. Still, Minister Tobin, in that press conference, announced that Canada was simply matching "Brazil's" support to Embraer.

80. Minister Tobin had no factual basis for that very regrettable and very untrue statement. Other Canadian officials, since January, have repeatedly, just as inaccurately and imprudently, repeated that statement. Neither Minister Tobin nor any official of the Canadian Government ever asked Brazil whether in fact Brazil was supporting Embraer in that transaction. Thus, while the Air Wisconsin transaction is far from the only transaction with which this dispute is concerned, it is a very important one. And the record shows that it was Canada, not Brazil, that supported the Air Wisconsin transaction with export subsidies that are prohibited by the WTO.

81. Canada provided support for the Air Wisconsin transaction through a Canada Account loan

rates provisions" of the Arrangement. Recourse to item (k) is, of course, an affirmative defence. Canada has the burden of establishing entitlement to that defence. In its previous submissions to the Panel, Brazil has already provided three reasons why Canada cannot do so. First, Embraer's offer to Air Wisconsin involved no support from the Brazilian government. Second, Canada did not match Embraer's offer, but rather offered more favourable terms. Third, "matching" does not bring a Member into "conformity with" the "interest rates provisions" of the OECD Arrangement.

(a) Brazil Neither Offered Nor Promised Support for the Air Wisconsin Transaction

86. Canada's justifications for its support for the Air Wisconsin transaction rest on the assumption that it "matched" a competing officially supported offer. As Brazil has previously explained, Canada's justifications fail for two reasons. First, had Canada complied with Article 53 of the OECD Arrangement, which requires a Participant wishing to "match" a non-participant's offer to "make every effort to verify" that the terms and conditions it is intending to match "are officially supported," Canada would have learned that Embraer's offers were for its own account and at its own risk. Embraer did not even request, let alone receive, support of any kind whatsoever from the Government of Brazil or from any other Brazilian government entity.

87. Canada's efforts at verifying Brazilian government participation in the Air Wisconsin fell considerably short of the standard included in Article 53 of the OECD Arrangement. According to Exhibit Cda-1 and paragraph 13 of Canada's First Written Submission, on 20 October 2000, a Bombardier salesperson "learned that Brazil was prepared to finance the sale of regional jets to Air Wisconsin on terms far more favourable than those that Air Wisconsin would have been able to obtain in the commercial marketplace."[73]

88. Between 20 October 2000 and 10 January 2001, when Industry Minister Tobin announced that Canada was "matching" Brazilian support for the Air Wisconsin transaction,[74] Canada did not contact Brazil to verify, in good faith, the accuracy of the information it had received. Canada therefore has not met its burden to show that it "made every effort to verify" that there was indeed Brazilian government support involved in Embraer's offer to Air Wisconsin. Moreover, as Brazil has demonstrated, Embraer in fact neither requested nor received any such support.

(b) Canada Has Failed to Prove That, Even If There Was Government Support by Brazil Offered or Promised to Embraer for the Air Wisconsin Transaction, Canada Matched the Offer

89. Even assuming that Embraer's offer was made with Brazilian government support, Canada must show that it matched that offer. Canada states that it was justified in extending "non-identical matching" to Air Wisconsin.[75] In its response to Question 36 from the panel, Brazil noted that "non-identical" matching does not appear to be available with respect to allegedly non-conforming terms offered by non-participants in the OECD Arrangement9.75 TD iTms that 8 t(f "non-identical") Tj T* -0.171

90. As evidence that it merely matched the terms of Embraer's offer, Canada offers a statement by an Air Wisconsin official that Canada's offer was "no more favorable than" Embraer's offer, "viewed in its entirety."[77] A statement by an airline interested in preserving the legality, and thus the viability, of its recently-negotiated deal is of limited use. Apart from the airline official's self-interest, it also appears that Air Wisconsin actually was contractually obligated to make this statement.[78]

91. Moreover, it is significant that the Air Wisconsin official stated that the two offers were equivalent in their "entirety." While matching only extends to the financing terms of an offer, the "entirety" of an offer goes beyond its financing terms. For example, Embraer's offer contained a special element unrelated to financing.[79] Thus, when Canada subsidized to "match" Embraer's offer (assuming Embraer's offer was actually matched) it did not simply match the financing. Instead, it used a subsidy to meet Embraer's offer in its "entirety," which went beyond financing.

92. Canada's argument that it matched Brazil's offer is also curious given its reaction of surprise and disbelief when it saw the terms of Embraer's offer, submitted by Brazil to the Panel on 25 June 2001. Canada stated on numerous occasions during the first meeting of the Panel that it still did not know some of the terms of Embraer's offer, and did not understand others about which it did know. But if Canada did not know or understand some of the key terms of Embraer's offer, how can it claim to have "matched" that offer?

93. It is Canada's burden to show that it actually matched Embraer's offer – term by term, component by component – so that the decisive factor in Air Wisconsin's choice was not the more favourable financing terms offered by Canada but, as Canada asserted at the first meeting of the Panel, the quality of the planes. Canada has not even attempted to do so, and thus has failed in demonstrating its entitlement to an affirmative defence.

(c) Canada Has Failed to Show that "Matching" Is a Practice Covered by the "Safe Haven" of Item (k)

94. Even if Embraer's offer included Brazilian government support, and even if Canada in fact matched that offer, Canada bears the burden of showing that recourse to matching maintains "conformity with" the "interest rates provisions" of the OECD Arrangement." Once again, Canada has failed to do so.

95. In its responses to questions from the Panel, Brazil has affirmatively demonstrated that matching does not bring a Member into conformity with the interest rates provisions of the Arrangement. Rather than repeating those arguments here, Brazil refers the Panel to its detailed response to Question 36 from the Panel.

96. In conclusion, Canada did not "make every effort to verify" that Embraer's offer to Air Wisconsin included Brazilian government support. In fact, Embraer neither sought nor received such support. Even if Embraer's offer had included government support, however, Canada did not merely match that support, even on "non-identical" terms. It in fact provided terms considerably more favourable than those included in Embraer's offer. Finally, even if Canada did match Embraer's offer, recourse to matching does not maintain "conformity with" the "interest rates provisions" of the OECD Arrangement. For all of these reasons, Canada has not established its entitlement to the "safe haven" included in item (k).

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[77] Exhibit Cda-2.

[78] Canadian response to Panel's 20 June 2001 request for information regarding the Air Wisconsin transaction, belatedly submitted 26 June 2001, Attachment (pg. 14) (One []).

[79] *See* Brazil's letter to the Panel of 25 June 2001, containing the description of the terms of the Embraer offer to Air Wisconsin, last paragraph.

2. Canada's Claim that by Offering Terms Equivalent to Embraer's Offer It Offered Market Terms of Financing Must Fail

97. Canada argues that if there was no Brazilian government support for Embraer's offer to Air Wisconsin, Canadian support matching Embraer's offer "would be on terms no more favourable than

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"entirety."[81] Whether Canada's offer was equivalent to Embraer's offer in its "entirety" is irrelevant, however. The offers may have been equivalent in their "entirety," at least in the judgment of a potential purchaser, because, for example, the more favourable terms of financing in one offer may have compensated better pricing or other incentives in the other. What Canada must do is demonstrate that the *financing terms* of the two offers were equivalent.

103. Canada cannot do so. As discussed above and in Brazil's 6 July response to Question 34 from the Panel, Embraer's offer contained a special element unrelated to financing,[82] and when Canada "matched" Embraer's offer in its "entirety," it did not simply match the financing terms of that offer. It used a subsidy to meet Embraer's offer in its "entirety," which extended beyond the financing of that offer.

104. Finally, the combination of a loan from EDC's Canada Account and an equity guarantee from IQ could not have been on terms comparable to the terms of Embraer's offer. By offering loan and equity guarantees, Canada transfers its high credit rating to the borrower and the equity investors and thus *always* confers a benefit. As Minister Tobin specifically acknowledged in his press conference, Canada was "using the borrowing strength and the capacity of the government to give a better rate of

108. This was made clear by Minister Tobin during his press conference. He stated: "What happens in the case of Embraer is that they were able to secure preferential, below commercial rates of interest in providing financing on the sale of aircraft, and that is something that Bombardier cannot do on its own."[85] Minister Tobin emphasized further: "What we're doing is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[86] Minister Tobin has, in fact, defined very precisely why Canada has conferred a benefit with its support for the Air Wisconsin transaction – because Canada provided Bombardier financing on terms that Bombardier could not otherwise obtain in the commercial market.

109. Canada's involvement in the Air Wisconsin transaction constitutes a prohibited export subsidy that does not fall within the "safe haven" of item (k). What Canada essentially told Bombardier was, "Go as low as you need to win the sale, we will do whatever is necessary to support you." No market lender would make such a statement to an unrelated vendor. Only an ECA would make such a statement, to a national vendor. By reducing the cost of the financing component of the Bombardier package to Air Wisconsin, Canada permitted Bombardier to avoid responding to Embraer's price competition to the degree that it would have to have done in order to match the overall cost (price plus financing)o Ater W by Bmbraer BInsomdoing Canada ponferred a brohibited Tj T* -0.1

credit rating.[92] Indeed, even if a governmental credit rating were no better than that of a manufacturer, such as Bombardier, a benefit nonetheless would be conferred on Bombardier because it would remove a potential liability from Bombardier's books, thereby enhancing Bombardier's credit rating. The IQ guarantee provided to Air Wisconsin therefore confers a benefit and constitutes a subsidy.

118. Canada has not addressed whether the guarantee to Air Wisconsin carries a fee. Brazil notes that while some of the earlier Québec decrees establishing and funding the IQ guarantee program for Bombardier customers indeed require IQ to charge annual fees,[93] Decree 1488-2000, which as discussed above was adopted to facilitate the Air Wisconsin transaction, eliminates the requirement of a fee altogether.[94]

V. INVESTISSEMENT QUÉBEC SUPPORT FOR THE CANADIAN REGIONAL AIRCRAFT INDUSTRY CONSTITUTES PROHIBITED EXPORT SUBSIDIES

A. Investissement Québec Constitutes a Prohibited Subsidy As Such

119. As Brazil noted in its First Written Submission,[95] IQ provides a range of support to purchasers of Canadian regional aircraft. These include loan guarantees, first loss deficiency guarantees to equity investors, and "any other form of intervention provided for in . . . [Investissement Québec's] business plan."[96] Canada has acknowledged that "the provision of such guarantees by a government or public body constitutes [a direct or] potential direct transfer of funds or liabilities within the meaning of Article 1.1(a)(1)(i) of the SCM Agreement and would therefore be a 'financial contribution.'"[97]

120. Canada argues that IQ guarantees are not susceptible to challenge "as such" because "[n]othing in the Investissement Québec Act mandates it to provide financing at all."[98] This is inaccurate. The series of Québec government decrees provided by Canada in its 6 July response to Question 9 from the Panel clarify that IQ guarantees to regional aircraft purchasers were issued pursuant to Article 28 of *An Act Respecting Investissment-Québec and Garantie-Québec* ("IQ Act").[99] Article 28 states that:

> The Government may, where a project is of major economic significance for Québec, *mandate* [IQ] to grant and administer the assistance determined by the Government to facilitate the realization of the project. The mandate may authorize the agency to fix the terms and conditions of the assistance.[100]

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[92] Standard & Poor's rating, as reported in "S&P affirms Bombardier rating," *The Globe and Mail*, 9 August 2000 (Exhibit Bra-63).

[93] See Décret 1187-98, 16 septembre 1998, concernant une participation de 150 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc., at (b) (Exhibit Cda-35). See also Décret 879-97, 2 juillet 1997, concernant la participation de la Société de développement industriel du Québec relativement à la vente d'avions par Bombardier Inc., at quatrième alinéa, (b) (Exhibit Cda-34).

[94] *See* Exhibit Cda-36.

[95] Brazilian First Written Submission, paras. 84-86.

[96] An Act Respecting Investissement-Québec and Garantie-Québec ("IQ Act"), Art. 25 (Exhibit Bra 18).

[97] Canadian First Written Submission, para. 87.

[98] Canadian First Written Submission, para. 42.

[99] Décret 1488-2000, 20 décembre 2000, concernant une participation de 226 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc. (Exhibit Cda-36); Décret 1187-98, 16 septembre 1998, concernant une participation de 150 000 000 $ d'Investissment-Québec pour la vente d'avions par Bombardier Inc.

121. Thus, when Article 28 serves as the legal basis for a decree under which IQ guarantees are provided in regional aircraft transactions, the Government of Québec "mandates" IQ to provide the assistance described in the decree.

122. Canada also argues that IQ guarantees are not susceptible to challenge "as such" because IQ is not required, with the provision of those guarantees, to confer a "benefit," within the meaning of Article 1.1(b) of the SCM Agreement.[101] This is likely a reference to the statement in Article 28 of the IQ Act that IQ may itself "fix the terms and conditions of the assistance." Thus, Canada appears to argue that even if Article 28, which serves as the legal basis for the decrees under which IQ guarantees are provided, "mandates" the provision of those guarantees, it does not mandate that the terms of those guarantees confer a "benefit," or in other words "terms more favourable than those available to the recipient in the market."[102]

123. This also is inaccurate. Loan guarantees are *per se* prohibited by item (j) to the Illustrative List of Export Subsidies. Moreover, Brazil has noted that any time a government issues a loan guarantee to a purchaser, the guarantee enables the recipient to borrow funds based upon the credit rating of the Government of Québec, which, as noted above, is A+ or A2. Since this is invariably superior to the credit rating of virtually any commercial purchaser, particularly one buying regional aircraft, loan guarantees issued by IQ thus confer a significant benefit by allowing firms buying Bombardier aircraft to borrow funds at a more favorable rate than would otherwise be available to them on the market. IQ does not maintain any discretion to forego this benefit; it is automatically dictated by the different credit ratings of the purchaser and the Government of Québec. Thus, IQ loan guarantees confer benefits, and constitute subsidies, "as such."

124. As discussed above with respect to the Air Wisconsin transaction, IQ equity guarantees similarly confer a benefit, by providing a governmental guarantee to equity investors, and thus making equity participation more readily available to the transaction. An IQ equity guarantee substitutes Québec's A+ to A2 credit rating for Bombardier's A- credit rating.[103] Indeed, even if a governmental credit rating were no better than that of a manufacturer, such as Bombardier, a benefit nonetheless would be conferred on Bombardier because it would remove a potential liability from Bombardier's books, thereby enhancing Bombardier's credit rating. Again, IQ does not maintain any discretion to forego this benefit; it is a function of the higher credit rating of the Government of Québec. Thus, IQ equity guarantees confer benefits, and constitute subsidies, "as such."

125.

. . . " However, and as Brazil also noted with respect to EDC guarantees, Canada makes no effort, in asserting its defence, to demonstrate that these fees are commensurate with those charged by commercial guarantors with A+ or A2 credit ratings to firms wishing to enjoy the benefits of those guarantors' A+ or A2 ratings.

126. Even if Canada could show that purchasers of regional aircraft enjoy the same credit rating as the Government of Québec, Article 14(c) of the SCM Agreement provides that a guarantee will still confer a benefit as long as "there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."[107] Whenever a regional aircraft purchaser – which inevitably has a lower credit rating than the Government of Québec – receives an IQ loan guarantee, there will be, in the terms of Article 14(c), a difference between the amount it pays on a loan and the amount it would pay on the loan absent the IQ guarantee. If not the letter, then the logic of Article 14(c) could similarly be applied to equity guarantees.

127. Thus, IQ is required to issue guarantees, and those guarantees will always confer benefits. IQ guarantees therefore constitute subsidies within the meaning of Article 1.1 of the SCM Agreement.

128. With respect to export contingency, in paragraphs 98-99 of its First Written Submission, Brazil demonstrated that IQ support for transactions involving the sale of goods such as aircraft are *de jure* contingent on the export of those goods outside of Québec. Canada claims that the IQ decrees relied upon by Brazil in those paragraphs of its submission do not apply to aircraft sales financing.[108] Those decrees most certainly do, however, apply to support for transactions involving the sale of goods. Regional aircraft are goods. The decrees thus require that every time IQ supports the sale of aircraft, it does so on the condition that the recipient export those aircraft outside of Québec. Moreover, Canada overlooks Brazil's citation to Article 25 of the IQ Act, which provides that IQ "shall participate in the growth of enterprises, in particular by facilitating research and development and export activities."[109]

129. Canada argues that a requirement to export outside of Québec is not equivalent to a requirement to export outside of Canada.[110] In its Oral Statement for the first meeting of the Panel, Brazil demonstrated that a requirement that recipients of IQ support export out of Québec is tantamount to a requirement that they export out of Canada.[111] Brazil noted that Canada's designation of part of its territory as ineligible for IQ support has the necessary effect of increasing the incentive of producers to export and the likelihood that they will do so because all of their home territory is not available to them. Canada seems to imply that, because nine of its 10 provinces remain eligible markets for the subsidized goods, this is somehow close enough to 10 out of 10. Under Canada's theory, IQ support would not be considered contingent on export as long as Canada made, say, Prince Edward Island eligible for IQ support for regional aircraft. This would subvert the export subsidy disciplines included in the SCM Agreement. If eligibility of part, but not all, of a Member's territory for a subsidy is enough to remove export contingency, many small, partial domestic eligibility designations are likely to follow rapidly. IQ guarantees are, therefore, *de jure* contingent on export.

B. Investissement Québec constitutes a prohibited subsidy as applied

1. Preliminary issues

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[107] The Appellate Body looked to Article 14 of the SCM Agreement as "relevant context" for the interpretation of the "benefit" requirement in Article 1.1(b) of the Agreement. WT/DS70/AB/R, para. 155.

[108] Canadian First Written Submission, para. 93.

[109] IQ Act, Art. 25 (Exhibit Bra-18).

[110] Canadian First Written Submission, para. 94.

[111] Brazilian Oral Statement, paras. 56-62.

130. In paragraphs 90-91 of its First Written Submission, Brazil discussed the provision of IQ guarantees to several Bombardier customers, including Mesa, Atlantic Southeast, Midway and Northwest Airlines.[112] The Panel noted, in Question 14 to Canada, that Canada had not denied IQ's involvement in those transactions.

131. While in its response to Question 14 Canada lists several Bombardier customers to which IQ provided guarantees, in paragraph 1 of its response, it states that IQ was not involved in the Atlantic Southeast or Northwest transactions. However, Canada does not deny that IQ's direct predecessor, the Société de développement industriel du Québec ("SDI"), was involved in the Atlantic Southeast and Northwest transactions. As discussed in paragraph 82 of Brazil's First Written Submission, in March 1998, IQ was effectively substituted for SDI, and took over SDI's operations in their entirety.[113] SDI in fact administered two of the Québec decrees (concerning guarantees for Bombardier customers) provided by Canada in response to Question 9 from the Panel.[114] Brazil requests that the Panel inquire of Canada whether SDI was involved in the Atlantic Southeast and Northwest transactions discussed in paragraph 91 of Brazil's First Written Submission.

132. As a matter of simple math, the list of transactions included in Canada's response to Question 14 cannot be complete. IQ spokesman Jean Cyr stated that at the time of the Air Wisconsin transaction, $300 million of a $450 million IQ fund established in 1996 to support Bombardier transactions had been used (additional funding was added to meet Bombardier's needs for the Air Wisconsin transaction).[115] Canada's list includes [] aircraft, each of which received a maximum [] per cent equity guarantee. Of those [ ] aircraft, [] received an additional [] per cent loan guarantee. If the average price of a Bombardier aircraft is $[] million, an equity guarantee of [] per cent on [] aircraft would equal $[] million. A loan guarantee of [] per cent on [] aircraft would be an additional $[] million, for a total of $[] million in committed funds. Mr. Cyr, however, stated that $300 million had been used. Canada has not accounted for this difference of nearly $[] million. Brazil requests that the Panel ask Canada to do so.

133. Canada lists several Bombardier customers to which IQ provided guarantees; namely, Mesa, Midway, Air Littoral, Atlantic Coast Airlines and Air Nostrum. Brazil notes, however, that Canada has not provided the information specifically requested by the Panel with respect to those transactions. Question 14 asks Canada to provide "all documentation regarding the review of these transactions by IQ," as well as "the credit ratings of the relevant airlines at the time of these transactions." Despite this specific request from the Panel, Canada has provided no documentation whatsoever regarding the review of these transactions. Nor has it provided the credit ratings of the customers.

134. This information is highly relevant to the Panel's determination whether the guarantees provided by IQ confer "benefits," within the meaning of Article 1.1(b) of the SCM Agreement. Brazil has noted that IQ guarantees provide benefits by making available the superior credit rating of the Government of Québec. Québec's superior credit rating allows firms with lower ratings to obtain

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[112] IQ guarantee support was also provided to Air Wisconsin. *See* Brazilian First Written Submission, para. 85.

[113] *See also* Article 1 of the

142. In its defence, and although it has provided no documentary proof, Canada claims that IQ charges fees for these guarantees.[118] Canada has not established, however, that these fees are commensurate with those charged by commercial guarantors with A+ or A2 credit ratings to firms wishing to enjoy the benefits of those guarantors' A+ or A2 ratings.

143. Canada also claims that []. [] might mitigate IQ's exposure, it does not mitigate the benefit conferred by the IQ guarantee on the recipient of that guarantee. Whether IQ manages to collect something from []. To whatever degree IQ participates, it contributes to the comparative attractiveness of Bombardier's offer.

144. In any event, it appears that the [].

145. Brazil refers to the Québec government decrees provided by Canada in response to Question 9 from the Panel. Those decrees, provided as Exhibits Cda-33 through Cda-36, establish the SDI/IQ guarantee program under which the guarantees discussed in Canada's response to Question 14 were granted. The 1996 decree provided as Exhibit Cda-33, in the preamble section at page 4303 (and in the operative section at page 4204), calls for the establishment of a company, the equity of which will be wholly-owned by SDI. The sole purpose of this company is to invest in a newly-established "société commerciale," which in subsequent decrees is identified as CQC.[119]

146. The 1996 decree also states that the société commerciale is to be capitalized with equal contributions from Bombardier and the company wholly-owned by SDI. Each is to contribute $100,000 and a sum equal to 10 per cent of the net price of each Bombardier plane that receives an SDI/IQ guarantee.[120] The 1996 decree expressly states that this capital is to be used to [] any guarantees provided to Bombardier customers by SDI/IQ.[121] Thus, even if [] to IQ guarantees were relevant to whether the IQ guarantees conferred a benefit on the recipient, it appears that the [] are made by CQC, an entity that receives half of its funding from IQ itself.

147. In its response to Question 14, Canada also notes that all IQ guarantees have been provided for terms exceeding the 10-year maximum included in the OECD Arrangement (for regional aircraft). As discussed in paragraphs 50-54 of Brazil's First Written Submission, terms beyond the 10-year maximum constitute "positive evidence" of a benefit, within the meaning of Article 1.1(b) of the SCM Agreement.

148. Finally, with respect to *de jure* export contingency, Brazil refers the Panel to the arguments made above regarding IQ "as such." Those arguments apply equally to the IQ guarantees in the transactions cited by Canada in its response to Question 14.

149. Those IQ guarantees are also *de facto* contingent on export. As noted by the Panel in *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather,* a Member's awareness that its domestic market is too small to absorb domestic production of a subsidized product indicates the subsidy is granted on the condition that it be exported.[122] Canada's 6 July responses to

[118] Canadian 6 July response to Question 14 from the Panel, para. 7.

[119] Exhibit Cda-36, at point (a) of the operative section; Exhibit Cda-35, at point (a) of the operative

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the Panel's questions illustrate its awareness that its domestic market cannot, and as a matter of historical fact has not, supported Bombardier's production of regional aircraft. Canada notes that 96.4 per cent of Bombardier's regional aircraft have been sold outside of Canada,[123] and that 100 per cent of the regional aircraft transactions receiving IQ support have been for export outside of Canada.[124] IQ guarantees are, therefore, also *de facto* contingent on export.

150. Brazil also notes that Canada's failure to comply with the Panel's request in Question 14 for "all documentation regarding the review of these transactions by IQ" makes it difficult for the Panel and Brazil to determine whether the IQ guarantees were in fact conditioned on export. Brazil reiterates its request that the Panel adopt adverse inferences, and presume that the documentation withheld by Canada would establish that the IQ guarantees were contingent on export, within the meaning of Article 3.1(a) of the SCM Agreement.

VI. COMMENTS ON CANADA'S RESPONSES TO QUESTIONS BY THE PANEL

151. Brazil received Canada's responses to the Panel's questions on Friday, 6 July 2001, but because of logistical difficulties faced by Canada, did not receive Canada's exhibits to its responses at the Brazilian Mission in Geneva until Tuesday, 10 July 2001. Accordingly, Brazil has not had adequate time to review those responses fully, and will have additional comments in its statement at the second meeting of the Panel later in greater detail on Canada's answers. For the moment, Brazil has commented on some of Canada's responses throughout this submission, and also adds the following brief comments.

152. Canada's definition of the "market" in response to question 4(b) appears inconsistent with its

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previously defined the "commercial market" to include Canadian government support provided through so-called "market window" operations.[126] For this reason, the Panel should seek additional clarification as to how many Bombardier transactions were financed in the commercial market, exclusive of any transactions in which Canadian government entities participated on a "market window" basis.

VII. CONCLUSION

154. For the foregoing reasons, Brazil requests that the Panel conclude that support for the Canadian regional aircraft industry through EDC's Corporate and Canada Accounts, as well as Investissement Québec, constitute prohibited export subsidies both "as such" and "as applied." Pursuant to Article 4.7 of the SCM Agreement, Brazil further requests a recommendation from the Panel that Canada withdraw these subsidies without delay.

[126] *See*, *e.g.*, paragraph 3 of Canada's answer to question 4: "EDC can and does participate in financing arranged by commercial banks on market terms."

ANNEX A-11

RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL PRIOR TO THE SECOND MEETING OF THE PANEL

(26 July 2001)

Canada

40. Please provide the credit ratings for Air Littoral, Atlantic Coast Airlines and Air Nostrum at the time of the transactions referred to in Canada's reply to Question 14 from the Panel.

Brazil considers that the Panel's question should also refer to Midway. Although Canada claims that no "public credit rating" was available for Midway, surely it applied its internal credit rating programme to gauge the risk involved in extending guarantee support valued at [] per cent of an approximately $[] million transaction. If IQ did not know Midway's credit rating, Brazil wonders how Canada can claim that IQ support for Midway is on market terms.

In Brazil's view, the Panel should also ask for additional information regarding how Canada generates the credit ratings for EDC transactions. In its response to the Panel's Question 4, Canada states that it generates internal credit ratings using financial modelling software. However, Canada has provided no information regarding exactly which data is input into its database, and how the database analyses the data. Accordingly, the Panel should ask the following questions:

> **Please explain in detail how the process of generating an internal rating works. Does this process rely solely on quantitative financial data or does it involve some subjective judgment? If non-quantitative factors are considered, please provide these factors and explain how they were considered in the generation of the rating.**
>
> **Please provide copies of all documents from industry sources used to generate credit ratings for the listed transactions.**

41. Please provide the documentation requested in Question 14 from the Panel, particularly in respect of the specific guarantee fees involved, and any [], or explain why such documentation is not available.

In addition, please provide all documentation regarding the review by IQ of the Air Littoral, Atlantic Coast Airlines and Air Nostrum transactions referred to in Canada's response to Question 14 from the Panel.

In Brazil's view, the Panel's question should also include Mesa and Midway. In response to Question 14 from the Panel, Canada stated that IQ provided guarantees to Mesa, Midway, Air Littoral, Atlantic Coast Airlines and Air Nostrum. Canada failed to provide "all documentation regarding the review of" not only the Air Littoral, Atlantic Coast Airlines and Air Nostrum

transactions, *but also the Mesa and Midway transactions*. Accordingly, Brazil asks that the Panel extend its request for documentation to include the latter two transactions.

Brazil also notes that Canada's initial failure to provide documentary information specifically requested by the Panel need not lead to renewed requests by the Panel for that information. As a participant before the Appellate Body in the earlier *Canada – Aircraft* dispute, Canada is well aware of the Panel's authority to adopt adverse inferences in response to a refusal to provide information requested by the Panel. Yet, Canada failed to provide that information. In Brazil's view, Canada's failure justifies the adoption of adverse inferences, as discussed in paragraph 136 of its Second Written Submission.

45. At paras. 74 and 75 of its second written submission, Brazil argues in essence that, for the ASA transaction, "EDC financial contributions were granted on terms more favorable than those available on the market." Please comment.

Brazil notes that in its response to the Panel's Question 11, Canada failed to provide any specific information regarding the benchmarks or credit ratings used for ASA. Instead, Canada states that it was able to impute a shadow investment grade rating for ASA based on the company's financial performance, which it claims to have provided in Exhibit Cda-44. However, Exhibit Cda-44 provides only the company's net accounts receivable days for 1991/1995 and accounts payable days for 1995. The Panel should ascertain whether these were the only financial results considered in establishing ASA's credit rating and, if not, obtain all of the information used to establish that rating.

Finally, Brazil notes that in its response to Panel Question 11, Canada states that although EDC's pricing was [] was [] approved. The Panel should ascertain whether EDC made any such exceptions in any other regional aircraft transactions, and if so obtain details regarding the circumstances of such exceptions.

48. At paras 66 and 67 of its second written submission, Canada states that IQ charges an up-front fee of [] basis points, and an annual fee equivalent to [] basis points on its effective exposure. In addition, Canada asserts that IQ is provided with a []. In its letter of 25 June 2001, which includes details of IQ's participation in the Air Wisconsin transaction, there is no reference to either an annual fee, or to a []. Please explain why IQ's participation in the Air Wisconsin transaction does not appear consistent with the practice set forth in the abovementioned paras 66 and 67.

In Brazil's view, the Panel should also ascertain whether IQ takes its up-front fee of [] basis points and its annual fee of [] basis points only on its effective exposure of [] per cent (its [] per cent guarantee minus a counter guarantee of [] per cent) or on its entire [] per cent guarantee. The Panel should also ascertain whether IQ has taken any equity positions in transactions in which EDC is providing any kind of financing or support.

<u>Brazil</u>

49. In its rebuttal submission (para. 38), Brazil argues that "EDC's Canada Account has fundamentally changed since it was first considered in Canada--Aircraft". Brazil then cites in a s) TD(ve) ng oestC is

50. At para. 75 of its second written submission, Brazil refers to the US dollar prime rate, and the CIRR, as of the date of its submission. Why is current data relevant for the purpose of assessing transactions dating from March 1997 and August 1998?

Brazil referred to the U.S. dollar rate and the CIRR as of the date of Brazil's submission simply for illustrative purposes. The main points of paragraph 75 are first, that the CIRR is calculated as 100 basis points above the seven-year U.S. Treasury rate, and that by providing financing at T-bill plus [], Canada's financing was presumptively below the market. More importantly, Canada's financing to ASA does not appear to reflect any risk premium associated with the airline's credit rating. Canada has previously stated that "in financing transactions, the credit risk premium is as important a constituent element of the final interest rate paid by a purchaser as the base to which the premium would be added."[5] Moreover, Canada has previously stated that the applicable risk premia for airlines such as Northwest and US Air are in the range of the 10-year U.S. T-bill plus 250 basis points, and that these airlines "enjoy credit standings significantly better than a number of airlines in the industry. Airlines that are less credit-worthy can face spreads as high as 350 bps."[6] Presumably, a small airline such as ASA would have a higher credit risk than US Air or Northwest. Brazil also notes that the offer provided to ASA (Exhibit Cda-43) states []. This appears to be a further illustration of how this transaction was on below-market terms.

51. Regarding para. 78 of Brazil's rebuttal submission, is financing based on a floating rate, e.g. LIBOR, unavailable in the commercial market? In addition, Brazil argues that "the margin added to LIBOR, a mere [] for a borrower that Exhibit Cda-39 reveals is rated, by Canada's own "LA Encore" system, as [], is below market by any reasonable definition." On what ground can Brazil argue that it is "below market"? In answering this question, please respond to Canada's Rebuttal, para. 40, in particular its argument that "EDC participated in the Kendall transaction, a public offering, on an equal risk-sharing basis with seven commercial banks".

While Brazil is aware of officially-supported floating rate transactions in the large aircraft sector, Brazil is not aware of any floating rate transactions in the regional aircraft sector that are not supported by government export credit agencies (whether or not acting through so-called "market windows"), and therefore cannot state with certainty that such financing is available in the commercial market.

Brazil notes further that floating rate transactions are not protected by the safe haven of item (k) of Annex I to the SCM Agreement. The Article 21.5 Panel in *Canada – Aircraft* stated that:

> [I]t would appear that the safe haven could only be potentially available to those specific kinds of official financing support to which the CIRRs . . . apply, given that these are the only *existing* systems of minimum interest rates under the *Arrangement*. . . . Given that they are expressed solely as fixed interest rates, the CIRRs can only meaningfully be applied to transactions with fixed interest rates. That is, there is simply no practical or meaningful way to apply rules concerning minimum *fixed* interest rates to *floating* rate transactions. Thus, we conclude that only official

[5] *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW (Adopted as modified by the Appellate Body, 4 August 2000), Annex 1-3, Oral Statement Of Canada, 3 February 2000, para. 79.

[6] WT/DS46/RW, Annex 1-3, Oral Statement Of Canada, 3 February 2000, chart 3 (submitted with Exhibit Cdn-14 to the Canadian Oral Statement) (attached as Exhibit Bra-64).

> financing support at fixed interest rates is subject to minimum interest rates, given that the CIRRs are expressed as, and thus can only apply to, fixed rate transactions.[7]

Brazil notes that Canada has not explained how its LA Encore system generates credit ratings, either by providing the input (the data used to generate the ratings) or the output (the ratings themselves) that this programme generates. The mere fact that Canada uses a computer programme that may also be used by commercial banks establishes nothing about *how* Canada uses that programme, or whether it generates (and Canada then uses) ratings that fully reflect all commercial risks associated with the transaction.

The margin of LIBOR plus [] bps for a borrower rated [] by Canada's programme is [] by Canada's own definitions. Canada has previously stated that LIBOR-based floating rates can be translated into equivalent U.S. T-bill-based fixed rates by adding a "swap spread" of approximately of [] to the LIBOR-based rate.[8] Thus, for example, Canada has stated that "British Airways, which is the best rated non-sovereign airline, obtains rates of LIBOR + 30 to 40 bps for large aircraft deals (an additional 20-30 bps should be added for regional aircraft, even for clients with British Airways' credit rating. This translates to T + 105-120 (+125-150 for regional aircraft)" when the swap spread is added.[9]

Canada has also stated that "[f]or the last nine years, the average yield spread for AAA credits has been approximately the 10-year Treasury Bond rate plus 43 basis points; and *no* airline enjoys such a rating,"[10] and that "in December 1999, a representative sample of airline companies operating in the US market obtained financing at T+110 to 250 basis points,"[11] and finally that the "interest rate payable by a borrower with a particularly poor credit rating may be in excess of T + 350 basis points."[12]

Thus, in Canada's own words, the appropriate spread for the best-rated airline for a regional jet transaction would be either LIBOR + 50-70 bps (floating rate) or T-bill plus 125-150 bps (fixed rate transactions). For a "representative" airline with a credit rating ranging from AAA to BBB-, the appropriate spread would be up to T-bill + 250 bps, which, adjusting for the swap spread, translates into a floating rate spread of LIBOR + 170 bps. An airline with a poor credit rating, such as BB,

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In any event, it appears that EDC funded [] per cent of the transaction, with the other [] per cent spread among four other underwriters.[14] While seven banks were originally contemplated as participating in the deal, three of the banks appear to have pulled out.[15] This would suggest that these banks considered the deal to be too unprofitable, or too risky, for their participation.

Several issues regarding the Kendell deal remain unresolved by the information provided by Canada. Would the commercial banks have been willing to finance the entire loan amount of the transaction on their own without the participation of a government export credit agency? Certainly,

The answers to these questions would provide much clearer information regarding EDC's participation in the Kendell transaction, and in particular, whether that participation was on terms that constitute a "benefit."

52. In what respects does Brazil believe that Bombardier's offer cannot qualify as "matching offer" under the OECD Arrangement? In particular, in para. 89 of its second written submission, Brazil argues that "[e]ven if 'non-identical' matching were permitted in this case, however, Canada bears the burden of showing that its 'non-identical' offer included financial terms that were economically equivalent to Embraer's offer." Is it Brazil's view that "economic equivalence" is the test to determine whether an offer can qualify as a valid "matching" under the OECD Arrangement? If yes, please explain why.

Canada's offer cannot qualify as a "matching offer" under the *OECD Arrangement* because it does not comply with specific obligations included in the *Arrangement* with respect to matching.

Most importantly, as Brazil has repeatedly observed, Canada did not fulfil its obligation, under Article 53 of the *Arrangement*, to "make every effort to verify" that terms allegedly not conforming with the *Arrangement* were "officially supported." Had it done so, with a simple request to Brazil, it would have discovered that support from Brazil was neither requested nor granted. Embraer's offer to Air Wisconsin was completely on its own account.

Even if Brazilian support had been involved, Brazil explained in its answer to the Panel's Question 36 that the terms and conditions of Canada's offer to Air Wisconsin are self-evidently not "identical" to the terms of Embraer's offer. The question then is whether Canada may offer terms and conditions that while not actually identical, nevertheless "match" the competing offer in that they result in essentially the same financial terms. As Brazil explained in its answer to Question 36, Article 52 of the *OECD Arrangement*

Even assuming, *arguendo*, (i) that Embraer's offer involved "official support" from Brazil, (ii) that Canada complied with the specific requirements regarding matching included in the *OECD Arrangement*, and (iii) that recourse to matching maintains "conformity with" the interest rates provisions of the *Arrangement*, Canada has not established that its offer to Air Wisconsin did not undercut Embraer's offer. Brazil has gone one step further, by explaining in its 6 July response to Question 34 of the Panel, and in paragraphs 89-93 and 102-118 of its Second Written Submission, why the terms of Canada's Air Wisconsin deal were more favourable than any offer made by Embraer, and hence cannot be said to "match" any such offer.

53. Regarding paras. 52 and 125 of its second written submission, is Brazil of the view that

ANNEX A-12

ORAL STATEMENT OF BRAZIL AT THE SECOND MEETING OF THE PANEL

(31 July 2001)

Mr. Chairman, Members of the Panel, Members of the delegation of Canada,

1. In its submissions thus far in these proceedings, Brazil has presented evidence that subsidies provided by Canada through the Canada Account and the Corporate Account of the Export Development Corporation, and subsidies provided by Canada through the Province of Québec, are prohibited by Article 3 of the Subsidies Agreement.

2. The public record, however, contains only fragments of the relevant information, and during the several years in which the dispute between Brazil and Canada has taken place, Canada has steadfastly refused to provide relevant information. Indeed most of the information Brazil was able to obtain came from third country sources where customers of Bombardier, the Canadian aircraft manufacturer, were required to disclose aspects of their finances to public investors. Very little came from Canada itself.

3. Thanks to the efforts of this Panel in taking its responsibilities under Article 13 of the DSU seriously, however, that situation has changed. You have asked the questions that needed to be asked, and Canada finally has come forth with information that should have been either notified to the Subsidies Committee long ago or provided to Brazil in consultations, consistent with the Appellate Body's requirement that Members be "fully forthcoming" at all stages of WTO dispute settlement proceedings.[1]

4. The bulk of that information was provided by Canada in its response to Questions from the Panel filed on Thursday, 26 July. In the two business days afforded to review that information, our team has been working ceaselessly in an effort to analyze it in the context of the issues presented in this dispute. There is much information, some of which, as I shall point out, raises even more questions.

5. Responding to this information, which we are seeing for the first time, will take some time, but we think it is important that we be as complete as possible. So I apologize in advance for the length of this statement.

6. This statement is organized in the following manner. In rebuttal to arguments made by Canada, I will show why EDC's Canada Account and Corporate Account confer a benefit, why the guarantees provided by IQ confer a benefit, why the guarantees provided by EDC and IQ are prohibited subsidies, and why IQ is contingent on export. I then will discuss specific transactions supported by the challenged Canadian programmes, beginning with the Air Wisconsin transaction.

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[1] India – Patent Protection for Pharmaceutical and Agricultural Chemical Products, WT/DS50/AB/R (Adopted 16 January 1998), para. 94.

7. Before I proceed, however, Mr. Chairman, I would like to make a preliminary point. In footnote 1 of its Second Submission, Canada asks Brazil to clarify whether by referring to "EDC," Brazil intends to refer to anything other than EDC's Corporate Account. Brazil is not aware that EDC has any operations other than Canada Account and Corporate Account, both of which are the subject of Brazil's claims. Canada's First Written Submission, at paragraph 20, describes EDC in these terms. If any other operations exist, however, Brazil, and, I am sure, the Panel, would be very interested to learn of them.

I. EDC Confers a Benefit

8. Canada has not contested that support *via* either the EDC Corporate or Canada Accounts is a financial contribution that is contingent on export. Canada has argued, however, that EDC Corporate and Canada Account support does not confer a benefit.

9. In response to Question 44 from the Panel, Canada argues that Bombardier's inability to make equally attractive financing available to its customer in the absence of EDC support is irrelevant. According to Canada, it is the purchaser of Bombardier aircraft, not Bombardier itself, that requires financing. In Canada's view, the financial contribution is made to the purchaser, so, therefore, the sole issue is whether the purchaser – the recipient of the financing – received a benefit.

10. Canada's argument is flawed. Nothing in the text of Article 1.1(b) of the Agreement suggests that there must be only one recipient of the benefit. That article does not read: "a benefit is thereby conferred *on the recipient of the financial contribution*." It states simply, "a benefit is thereby conferred," meaning, conferred on anyone.

11. EDC's financial contribution allows Bombardier to offer its customers a product on terms more favorable than the terms it could afford to offer without EDC's support. A benefit is conferred on Bombardier because, as a result of the financial contribution made through EDC, the necessity for Bombardier to lower its price in order to win customers is eliminated or reduced. The Panel in *Brazil – Aircraft* recognized that a financial contribution provided to a purchaser or a lender in support of an export credit transaction also benefits the producer. That Panel said:

> We note that PROEX III payments are made in support of export credits extended to the *purchaser*, and not to the *producer*, of Brazilian regional aircraft. … [These] payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market … [T]his will … confer a benefit on the *producers* of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products.[2]

12. Canada's claim that EDC's Corporate Account operates "on commercial principles" has no bearing on this conclusion. In spelling out an alleged market benchmark in paragraph 67 of its First Written Submission, Canada focuses unduly on its claim that Bombardier customers do not receive "benefits" from EDC Corporate Account support. In so doing, it ignores a key beneficiary of the transactions – Bombardier itself, which uses EDC because it cannot find equally favourable financing elsewhere.

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[2] *Brazil – Export Financing Programme for Aircraft – Second Recourse to Article 21.5 of the DSU*, WT/DS46/RW/2 (26 July 2001) (Not yet adopted), para. 5.28 (note 42) (emphasis in the original).

II. The Guarantees Provided by IQ Confer a Benefit

A. The guarantee fees charged by IQ are not "at market"

13. As with EDC, Canada claims that IQ charges "market" fees for its guarantees. Canada argues, in its answer to Question 47 from the Panel, that the guarantee fees charged by IQ are at the market rate because "the effective risk exposure of IQ," which "is key to the determination of what constitutes an appropriate fee," "is greatly diminished" as a result of [ ].[3]

14. There are a number of points to be made with respect to that argument. **First**, []. By providing guarantees to the borrower, IQ facilitates more favourable financing terms because of Québec's superior credit rating, thus conferring a benefit. This is what "sweetens" the deal for the purchaser of Bombardier aircraft, and therefore, for Bombardier itself. That IQ might be provided [] is irrelevant to the question of "benefit."

15. The Air Wisconsin transaction provides a perfect illustration of Brazil's point. By Canada's own admission, the [] "is not part of the offer to Air Wisconsin" because the []."[4] When the purchaser goes to a lender or looks for equity investors with an IQ guarantee, the lender or the investors see only the full [] per cent IQ guarantee backed by the credit rating of the Government of Québec. The [] might mitigate IQ's exposure, but does not reduce the benefit to purchasers and Bombardier.

16. **Second**, contrary to Canada's assertions, it appears that the []. As Brazil has explained in paragraph 144 of its Second Written Submission, the [] appear to be issued by Canadair Québec Capital ("CQC"), a company capitalized in equal parts by Bombardier and a company wholly-owned by IQ. Thus, the [] to the IQ guarantee is made by an entity that receives part of its funding from IQ itself. In paragraph 3 of its response to Question 48 from the Panel, Canada refers to Decree 879-97 of 1997 in support of the proposition that []. However, the provision referred to by Canada relates to the capitalization of CQC. Further, a subsequent decree, Decree 1187-98 of 1998, makes it clear that the [] must be provided not by [] but by CQC, a company created specifically for that purpose.[5] []

17. In this regard, Brazil would also like to point out the significance of Bombardier's involvement in the guarantees provided by IQ. The activities of IQ and Bombardier are intertwined to a very significant extent. Together, they formed CQC for the purpose of providing [] against IQ's guarantees to Bombardier and otherwise facilitating Bombardier's activities. Bombardier, as a [], obviously has an important role in determining the terms and conditions for the provision of the [] and, therefore, has an influence on the terms and conditions of the provision by IQ of the guarantees themselves. In fact, through CQC, IQ and Bombardier are business partners for the purpose of supporting and facilitating the export of regional aircraft.

18. I would like to point out, in addition, that at paragraph 117 of Canada's Second Written Submission of 4 December 1998 in *Canada - Aircraft*, Canada stated that *none* of the guarantees or financing activities under the "export development" eligibility criterion of SDI (which became IQ in 1998) was related to the civil aircraft sector.[6] In this case, however, Canada has been compelled to provide documentation demonstrating not only that IQ has, in fact, been used to assist the Canadian regional aircraft industry, but that assisting the Canadian regional aircraft industry is one of the major functions of IQ and that IQ works very closely with Bombardier to that effect – and apparently was doing so prior to December 1998.

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[3] Canadian 26 July response to Question 47 from the Panel, para. 2.
[4] Canadian 26 July response to Question 48 from the Panel, para. 3.
[5] Decree 1187-98, pg. 1, para. (a) (Exhibit Cda-35).
[6] *See* Statement of Brazil for the First Meeting of the Panel, para. 72 and Exhibit Bra-52.

19. **Third**, Canada argues, in paragraphs 3 and 4 of its response to Question 47 from the Panel, that "[] per cent of the aircraft being financed are financed without IQ equity guarantees," which "demonstrates that most of the time, Bombardier's customers are, at best, indifferent to IQ equity guarantees." The conclusion drawn by Canada is that "the fees charged by IQ in return for the guarantees are market rate."

20. Canada's logic is flawed. The fact that [] per cent of the aircraft being financed are financed without IQ equity guarantees is irrelevant. What matters is the terms of IQ equity guarantees in the cases where they are provided, whatever the percentage of those cases is. Brazil has shown that IQ confers a benefit whenever it provides a guarantee. Moreover, as Canada has explained in its response to Question 39 from the Panel, IQ has used virtually all of the funds available in its budget for support of the Canadian regional aircraft industry. Presumably, if IQ had a larger budget for that purpose, more funds would have been used to provide equity guarantees. In fact, in December 2000, the IQ fund for regional aircraft support was replenished to support the Air Wisconsin transaction.

24. As I have already noted, IQ guarantees will automatically confer a benefit by providing a purchaser with the Government of Québec's superior credit rating, permitting it to obtain better financing than it could obtain on its own. To demonstrate that there is no benefit, Canada would have to prove that IQ's fees are equal to those charged regional aircraft purchasers by commercial

domestic content). Further, export credits that conform to the interest rates provisions of item (k) are not prohibited. Moreover, an export loan guarantee at premium rates adequate to cover the long-term operating costs and losses of the programme would arguably be permitted under an *a contrario* interpretation of item (j). We understand, of course, from the position Canada took in *Brazil – Aircraft*, that it does not believe that such *a contrario* interpretations attach. This, however, is an issue the Panel need not reach, since Canada has not raised an item (j) defence.

IV. IQ Support Is Contingent on Export

30. Canada argues that IQ support is not contingent in law or in fact on export. Brazil has demonstrated otherwise. Article 25 of the IQ Act provides that IQ "*shall* participate in the growth of enterprises, in particular by facilitating research and development and *export activities*." Thus, IQ is required to participate in export activities. It has fulfilled that requirement by granting support under Québec decrees that establish a fund *available solely for transactions involving Bombardier aircraft*.[16] And as Canada itself noted in its response to Question 19, every single regional aircraft transaction receiving IQ support under these decrees has been an export sale outside of Canada. Regional aircraft transactions are a perfect illustration, therefore, of the requirement in Article 25 that IQ support export activities, and the decrees included in Canadian Exhibits 33-36 are measures that represent IQ's fulfilment of that requirement.

31. Adding to IQ's *de jure* export contingency, I refer to other Québec decrees discussed in paragraphs 98-99 of Brazil's First Written Submission. In paragraph 35 of its Second Written Submission, Canada overlooks the second decree cited by Brazil – number 841-2000, regarding the Program for Financing Enterprises. That decree concerns IQ support for market development projects, including the sale of goods. It states that IQ support for transactions involving the sale of goods may only be ez 0.0844 sponse to Question 19, eve Tw sponsanly be d1ncernlosses of th, Cann air8qD -h-2 082 Support Financid in Canad rppliforouestioch e0.4375 Tc 0 Tw (31.) Tj 36 0 TD -0.2345 Tc 0.172 Tw (I9nterpris

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aircraft. The "necessary implication" of these words is that the guarantees are to support exports. Canada itself admits that a full 100 per cent of the aircraft receiving these guarantees have been exported.[20] Both the officials who grant the guarantees and the recipients themselves understand the "necessary implication" of the "the words actually used in the measure."

35. These same factors mean that IQ guarantees are also contingent in fact on export, or "tied to actual . . . exportation." Regarding *de facto* export contingency, I refer the Panel to the decision in *Australia – Leather*. That Panel stated that a Member's awareness that its domestic market is too small to absorb domestic production of a subsidized product indicates that the subsidy is granted on the condition that it be exported.[21] Canada is of course aware that 100 per cent of the regional aircraft transactions receiving IQ support have been for export outside of Canada. IQ guarantees are "tied to actual . . . exportation" because IQ will not grant them unless an actual export sale of a regional aircraft occurs. IQ guarantees are, therefore, also *de facto* contingent on export.

V. The Air Wisconsin Transaction

36. Much has been said about the Air Wisconsin transaction, which involved both Canada Account and IQ support. Canada has acknowledged that its support for the Air Wisconsin deal constitutes a subsidy. Industry Minister Tobin stated it very clearly: "What we're doing is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[22] He could hardly have paraphrased the Appellate Body's definition of the term "benefit" better.

37. As I already noted, there was both Canada Account and IQ support for the Air Wisconsin deal. I will begin by addressing the three things Canada must establish to justify Canada Account support for the Air Wisconsin deal under item (k), given Tobin's acknowledgement.

38. **First**, Canada must show that it followed the requirements included in the matching provisions of the *OECD Arrangement.* Canada did not do so. It did not, for example, "make every effort to verify" that Brazilian official support was involved in Embraer's offer to Air Wisconsin. The fact of the matter is that Brazil was not involved in Embraer's offer to Air Wisconsin, and a simple question to Brazil at some time during the many months while the deal was pending would have resolved the matter. Since Brazil was not involved in Embraer's offer to Air Wisconsin, the column marked "Brazil" in the Annex to Canada's 26 July responses to the Panel's questions should be blank.

39. **Second**, Canada must demonstrate that its "non-identical" offer matched Embraer's offer. Again, it has not done so. To "match" means to offer financial terms that are the same, or at least equivalent.

40. **Third**, Canada would need to show that recourse to matching maintains "conformity with" the interest rates provisions of the *Arrangement*. As Brazil explained in its 6 July response to Question 36, however, this is not the case.

41. Canada has not satisfied these three requirements. Consequently, it argues in the alternative that Canada Account support has not conferred a benefit on Air Wisconsin. When Canada matched a private offer from Embraer, however, it conferred a massive benefit on *Bombardier*. By taking care of the financing, Canada insulated Bombardier from the need to lower its price to clinch the deal. As one example, although [] are listed in both the "Canada" and "Brazil" columns on page v of the chart included as Exhibit A to Canada's 26 July responses to questions from the Panel, Canada is well aware that the Government of Brazil does not provide these []. While Embraer had to bear the cost of this [] itself, Canada bore that cost for Bombardier.

42. I will now briefly return to the subject of IQ equity guarantees in the context of the Air Wisconsin deal. Canada's defence is that IQ charged Air Wisconsin a fee for the guarantee. This does not appear to be true. As I have already noted, the December 2000 Québec decree that facilitated the IQ guarantee for the Air Wisconsin deal removes the requirement, present in earlier decrees, that a fee be charged. []

43. Even if IQ charged a fee of [] basis points for the guarantee, Canada must do more than simply state, again in its response to Question 48, that "[s]uch a [] basis point administrative fee is routinely charged by any commercial financial institution." Canada has not provided one example of an equity guarantee provided by any commercial financial institution, at any time, in any place, for any fee, much less an example in which a [] basis point fee is charged.

44. While Canada has provided the Panel with documents regarding other IQ guarantees,[24] *it has failed to do so for the Air Wisconsin guarantee*. Documents provided by Canada about other IQ guarantees demonstrate that 60 per cent of the other regional airlines receiving those guarantees have [] credit ratings. Since Canada has not provided the relevant document with respect to the Air Wisconsin transaction, the Panel should presume that Air Wisconsin's credit rating is similarly []. Canada itself described Air Wisconsin as "a relatively low quality credit."[25] Canada has not established that a commercial financial institution with an A+ credit rating would charge [] basis points to provide a guarantee to a [] credit risk. IQ support for the Air Wisconsin transaction therefore confers a benefit, and constitutes a subsidy.

45. I have already noted that partial [] provided by CQC or [] are irrelevant, and do not dilute the value of the IQ guarantee for the recipient and Bombardier. Such a [] might mitigate IQ's exposure, but it does not reduce the benefit to the recipient or Bombardier.

VI. Other Transactions

46. I would now like to discuss the evidence before the Panel regarding particular transactions other than Air Wisconsin supported by EDC and Investissement Québec that are at issue in this dispute. Before I go through the terms of each transaction in detail, I will explain how we determined that, based on the evidence provided by Canada, the transactions at issue in this dispute were financed at below "market" rates. I would also like to make some general comments regarding the methods used by Canada to determine the market rates for each transaction.

A. Methodology

[24] Exhibits Cda-60 through Cda-64.
[25] Canadian Second Written Submission, para. 92.

1. Previous statements and benchmarks used by Canada

47. The first method we used to determine whether Canada financed at "market" rates was to compare the rates for each transaction with what Canada itself has said about the market for regional jets. A little over a year ago, as may be seen in Brazilian Exhibit 64, Canada stated that the applicable risk premia for major airlines such as Northwest and US Air are in the range of the 10-year US T-bill plus 250 basis points. Canada also stated that "British Airways, which is the best rated non-sovereign airline, obtains rates of LIBOR plus 30 to 40 bps for large aircraft deals (an additional 20-30 bps should be added for regional aircraft), even for clients with British Airways' credit rating. This translates to US T-bill plus 105 to 120 basis points (125 to 150 for regional aircraft)" when the appropriate swap spread is added.[26]

provide more examples of how Canada's ratings, and the spreads it associates with those ratings, are inconsistent with the market.

53. Canada also relies extensively on its LA Encore software system to establish credit ratings for airlines involved in EDC or IQ transactions. As Brazil pointed out in its reply to Panel Question 40 on 26 July, there is not much information available about how the LA Encore system actually works. We do not know precisely which data are input into the system, what weights are given to each parameter, and whether or not subjective criteria are used in evaluating the data.

54. Nevertheless, it appears clear that the LA Encore system is not reliable. Canada states that in 1996, using a pre-LA Encore methodology, it assigned Comair a rating of [].[31] Subsequently, Canada input Comair's 1996 data obtained from the FAMAS commercial financial analysis system into the LA Encore system and generated a rating of [], which is [] full notches [] the rating estimated by EDC. Similarly, in its response to Question 45, Canada explains that prior to using LA Encore, Canada rated ASA, at the time of its first letter of offer, as []. Canada goes on to say that had LA Encore been available, it would have assigned a rating of [] to ASA, which is a full [] notches [] the previous rating. These facts suggest that either EDC's own ratings or the ratings generated by the LA Encore system are consistently inaccurate. Canada does not appear to have further investigated these discrepancies or revised the LA Encore system to adjust for the difference between its output and Canada's own previous estimates. We are left, therefore, with a software program that when used by Canada, seems to overstate credit ratings by anywhere from [] to [] notches. Given that each notch may account for a difference of approximately 15 basis points in the spread offered to a company, this discrepancy could make a difference of between [] and [] basis points in an offering spread. This raises serious questions regarding the reliability of offers developed based on the LA Encore output.

3. Canada Uses Comparables That Are Not Reliable

55. The problem with Canada's use of inflated ratings is that it enables EDC to bypass the risks associated with the regional jet market and instead base its regional jet financing on a comparison with industrial papers that carry far less risk and are completely unrelated to the regional jet market. For example, in one pricing matrix in Exhibit 59, Canada has rated Comair – a company never rated by Standard & Poor's – as an [] grade, and proceeds to base Comair pricing on comparisons with companies like []. This just does not make sense.

56. In fact, we have found that in most cases these comparables are simply not reliable or useful in determining market rates for regional jet financing. But first, let me discuss the most important comparable that Canada has *not* used. Canada does not appear to have used any data regarding regional jet transactions that did *not* involve government support as benchmarks to determine market rates. Brazil notes that in its response to Panel Question 43, Canada stated that over [] per cent of Bombardier's sales did not involve any government support, even through so-called "market window" operations. These transactions should surely provide a plentiful and accurate resource for determining the appropriate market rates for Canada's officially-supportctioR2it50o5.0.1127 t a dicult0.207Canada Tc 0 Tw (not

regional jets. The value of the collateral enables airlines with poor credit ratings to obtain better credit ratings than they would otherwise hold.

63. EETCs have been particularly successful in the North American market because of a provision of the US bankruptcy code which permits holders of the security to obtain almost immediate possession of the aircraft used as collateral in the event of an airline defaulting and filing for bankruptcy. This explains why the EETCs have not yet become popular in European and other markets.

64. As these details suggest, there are considerable differences between an EETC issue and a straightforward bank-financed loan. These include the fact that EETCs are securitized transactions in a secondary market, that EETCs generally are secured by large rather than regional jets, that EETCs are generally not used outside the North American market, and that the credit ratings may be affected by the size and the term of the transaction. For these reasons, the credit risk or spread on a EETC issue would generally be lower than the spread that the same airline could obtain in a commercial bank-financed transaction. Canada has used the EETC spreads as a benchmark for determining market rates, both in the *Brazil – Aircraft* case, as Brazil has shown in its Exhibit 64, and in this case itself, as in Canadian Exhibit 17. Therefore, Brazil considered it appropriate also to rely on the EETC spreads as a benchmark. Accordingly, Brazil has compared the rates offered by Canada with spreads in EETC transactions, in several different ways.

65. First, Brazil compared the spreads offered by Canada with the weighted-average of the spreads at which all EETCs issued by each airline were trading at the time of the Canadian offer. These comparisons are provided as Exhibit Bra-65. When I review the details of each transaction for which data is available, I will show how the spreads offered by Canada are in every instance lower than the spreads at which EETCs are trading.

66. Second, as a cross-check, Brazil compared the spreads offered by Canada with an estimate of the likely spread for that transaction based on the average spreads for all EETCs in the year in which the transaction took place. For this comparison, Brazil took the average offering spreads from all EETCs issued in the year of each Canadian transaction as its starting point. We then added the impact of the credit rating of the company based on Canada's ratings, with which, I emphasize, we do not agree. This impact was calculated as plus or minus 15 basis points based on an analysis of all EETCs offered during the period 1996-1999, which is the period covering the Canadian transactions at issue here. As shown in Exhibit Bra-66, Brazil compared the spread offered by Canada, where known, to the constructed spread based on the EETC spreads to determine whether EDC's rate was below market.

67. Much of the available data regarding Canada's transactions were provided in its responses to the Panel's questions on 26 July. Accordingly, Brazil has not had time to do a comprehensive analysis of these transactions in the two business days since it received Canada's latest data. Nevertheless, several things are clear: first, for the reasons I have just explained, Canada's methods of setting rates for officially-supported financing are not compatible with the market; second, Canada's financing is for terms longer than permitted under the *OECD Arrangement*; and third, as I will now show, Canada's rates for particular transactions were well below any reasonable definition of the market.

B. Transactions

1. Atlantic Southeast Airlines

68. Canada offered financing to Atlantic Southeast Airlines (ASA) in several steps. Again, I will discuss these sequentially. ASA bought [] CRJ 200 aircraft, with options on an additional [], from

Bombardier in April 1997. The terms of EDC's offer are provided in Canadian Exhibit 42. EDC financed up to [] per cent of the price of these aircraft, at a rate of US 10-year T-bill plus [] basis points. The financing had a term of [] years.

69. Let us first look at the credit ratings assigned to ASA by Canada in April 1997. Canada states in response to Question 45 that at the time of the first offer, it did not have its LA Encore software available and therefore relied on a [] for ASA of [], making ASA []. By the time of the second offer, LA Encore had been developed and gave ASA a credit rating of [].

70. Quite apart from the discrepancy between EDC's own ratings and the LA Encore ratings, to which I have previously referred, ASA's ratings stand out in []. Brazilian Exhibit 67 shows the Standard & Poor's credit ratings history for most major US airlines. According to the Standard & Poor's ratings, in April 1997, [] had a rating of [], [] had a rating of [] (changing to [] in late April) and [] had a credit rating of []. Yet Canada assigned ASA, a small regional airline, a rating of []. Canada has not explained why ASA's rating should be [] than these other major airlines.

71. The pricing at T-bill plus [] points for this transaction is plainly below market. As Canada has previously stated, the best-rated airline could only hope to obtain spreads of T-bill plus 125 basis points, at a minimum. Moreover, the table provided as Exhibit 66 shows that this transaction was approximately [] basis points below the estimated market pricing.

72. On 26 August 1998, Canada offered additional financing on similar terms as the first offer, as shown in Canadian Exhibit 43. By now LA Encore had given ASA a rating of []. However, [] was rated [], [] was rated [], [] was rated [], [] was rated [], and [] was rated []. Today, the two highest rated airlines are [], which has an [] rating, and [], which has a [] rating. Again, ASA, a regional airline which is not rated by the major ratings agencies, was given a [] rating than any of these companies, and Canada does not explain why.

73. ASA's spread is also at odds with the market. Canada offered ASA financing at T-bill plus [] basis points. The most immediate measure of how this is below the market is that it is [] prevailing at this time. As the Panel is aware, the Appellate Body has stated that a rate below the CIRR is a "positive indication" that the government support provides a material advantage and is presumptively below the market.[32] Furthermore, Canada stated before the first *Brazil – Aircraft* Article 21.5 Panel that on certain occasions it has provided financing at rates below the prevailing CIRR.[33] However, Canada explained that it only did so because of the time lag required for the CIRRs, which are announced monthly, to adjust to the market. As we will see today, Canada has offered [] on at least two occasions, based on our review of the very limited number of transactions for which data are before the Panel.

74. The US dollar denominated CIRR in effect on 26 August 1998 was 6.52 per cent. The monthly average 10-year T-bill for August 1998 was [] per cent. Thus, Canada's effective rate of [] per cent plus the spread of [] basis points gives a total rate of [] per cent. This is [] basis points []. Canada bears the burden of rebutting the presumption that this rate is below the market. This Canada has failed to do. Furthermore, Canada's assertion that it [] simply because of a time lag does not withstand scrutiny. Because the CIRR is set at the 7-year Treasury plus 100 basis points, by pricing at 10-year T-bill plus []. Brazilian Exhibit 70 contains the source documentation for the applicable CIRR and T-bill rates.

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[32] *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R (Adopted 20 August 1999), para. 182, n.2.

[33] WT/DS46/RW, Annex I-4, question 4(a).

75. In addition, this spread is below what Canada has previously said the best-rated non-sovereign airline could expect to get in a regional jet transaction. Moreover, as the graph included in Exhibit 65 shows, it is below the weighted-average of all the EETCs trading for each of the companies participating in the EETC market in July 1998. To the extent that EETCs represent the market, EDC's financing to ASA is []. Finally, the table provided in Exhibit 66 shows that ASA's spread is [].

76. Finally, Canada has not established that there is an alternative market benchmark below the CIRR, nor has it pointed to *any* truly commercial operations comparable to these transactions.

2. Comair

77. Let me know turn to the Comair transactions. Before addressing the substantive issues in these transactions, I would like to discuss one preliminary point concerning the obligation placed upon Members by Article 3.10 of the DSU to engage in WTO dispute settlement in good faith. The extent to which this obligation is ignored, and the difficulties Members face in enforcing Canada's obligations under the Subsidies Agreement, is nowhere more evident than in the case of the Comair transaction.

78. In its First Written Submission, Brazil cited to Comair filings with the US Securities and Exchange Commission stating that EDC supported Comair purchases of Bombardier jets with guarantees. Canada denied this claim in paragraph 65 of its First Written Submission.

79. Canada denied the claim because Brazil – or rather Comair's filings with a US Government agency – misidentified the form of support involved – guarantees as opposed to loans. Brazil was not merely relying on rumour to substantiate its claim, however. It relied on official filings by Comair to an agency of the US government that, by the way, identified the correct vehicle for Canadian support – EDC. In these circumstances, for Canada to sit back and remain silent about EDC support for the transaction simply is not consistent with its obligation to participate in these proceedings in good faith.

80. And in any event, we now discover that Comair's filings with the US SEC were actually correct. In footnote 1 to its 26 July response to Question 37, Canada acknowledges that EDC did in fact provide guarantees for the Comair transaction, including in 1995, after the effective date of the Subsidies Agreement. Because these guarantees were provided by EDC's *Canada Account*, rather than its *Corporate Account*, Canada felt it was consistent with its good faith obligation to deny Brazil's claim. But Comair's US SEC filings simply refer to "EDC," without specifying Canada Account or Corporate Account. Canada's denial of Brazil's claim was therefore untruthful. Canada has not provided information about the 1995 guarantees to Comair described in footnote 1 to its response to Question 37. Under the circumstances, Brazil requests that the Panel presume that those guarantees were granted on below-market terms.

81. It appears that Brazil has fallen prey to similar Canadian tactics with respect to the 1999 Northwest transaction identified in Brazil's First Written Submission. While Canada denied IQ or SDI support for Northwest and ASA in its responses to Questions 14 and 38 from the Panel, it acknowledged EDC support for ASA. It has remained silent regarding EDC Corporate or Canada Account support to Northwest for the 1999 deal, however. Because the extent of Canada's tactics are only now coming to light, Brazil requests that the Panel ask Canada whether EDC Corporate or Canada Account support was provided for this deal.

82. Allow me to turn to the substantive issues raised by the Comair transactions. In its submission of 26 July, Canada acknowledged that it provided loans into US leveraged lease structures for [] aircraft delivered from 1996 to 2000. Canada provided an explanation of how it priced the

financing for these deliveries that raises far more questions than answers. For example, Canada states that EDC had estimated Comair's credit rating in April 1996 to be [].

83. Canada also states that, using the LA Encore software, it now estimates Comair's 1996 credit rating as []. As I have noted, this discrepancy suggests that the software is not reliable. I might also add that the LA Encore estimate of Comair's credit rating is flatly contradicted by Canada's statement in the *Brazil – Aircraft* proceedings that [].

84. Canada offered pricing in April 1996 at T-bill plus [] basis points. This is [] basis points below EDC's [] and also is [] than the spread of T-bill plus [] to [] basis points that Canada has said the best-rated non-sovereign airline, [], can obtain in the market for regional jet transactions. Once

92. Canada states in its responses that as of its February 1999 offer, Comair's rating had [] another [] notches to [], even though Comair was considered "first among its peers in the industry." Again, Canada does not explain the inconsistency. Canada now offered a fixed rate of T-bill plus [] points, based on increase in EDC's cost of funds, according to Exhibit 59. I would note that Canada's response to Question 37 states that the offer was at T-bill plus [] basis points, but the 11 January memorandum provided in Canadian Exhibit 59, which was not discussed in Canada's written answers, approves the transaction at T-bill plus [] basis points. This memorandum further notes that EDC's cost of funds was T-bill plus [] basis points – only [] basis points [] than the approved offer – and [] basis points below EDC's [].

93. It seems impossible that Canada could consider an offer of [] basis points [] its cost of funds to be at market for a fixed rate loan with a term of [] years. It also seems impossible that Canada would consider a return of [] basis points [ ] its cost of funds, and [] points [] its [], to be a "market" level risk for a fixed rate loan to a company with a rating that has been [] steadily according to its own LA Encore software. I note that before the first Article 21.5 Panel in *Brazil – Aircraft*, Canada told the Panel that while spreads of less than 10 basis points are common in the large aircraft sector, spreads of less than 20-30 basis points, net of risk premia and transaction costs, would be "unlikely" in the regional jet sector.[34]

94. Moreover, even assuming the February 1999 offer was at T-bill plus [] basis points, this was still well [] the EETC market. As the chart provided as Exhibit 65 shows, EDC's offer to Comair at that rate was [] than the rates at which all EETCs issued by other airlines were trading in that month. Furthermore, this pricing was also [] the estimated market spread for this transaction, shown in Exhibit 66.

3. Atlantic Coast Airlines

95. Canada offered financing to Atlantic Coast Airlines (ACA) in several steps. While it is not entirely clear from the materials provided by Canada which terms applied to which aircraft, Brazil has identified several different deals that appear to have been financed by Canada. I will discuss these in chronological order.

96. In its Exhibit 59, regarding Comair's pricing, Canada refers to February 1996 pricing to ACA in which EDC offered pricing of T-bill plus [] basis points to ACA. Canada states that it rated ACA as [] at that time. Canada's pricing is [] basis points [] the spread of T-bill plus [] points that Canada has said we may expect for representative airlines, and certainly below what we might expect for a small regional airline with [].

97. I would also point out that the pricing offered to ACA is well [] the spreads at which the [], on which Canada itself relies, were trading in February 1996. I refer you to Brazil's Exhibit 68, which shows the [] over the period 1996-2001 for various credit ratings for industrial spreads. As you will see, [] rated companies were above [] basis points in February 1996. I would also refer you to the table provided in Brazilian Exhibit 66, which estimates that EDC's financing for this transaction was approximately [] basis points below the estimated market spread.

98. In its answer to Question 14, Canada states that it provided IQ equity guarantees for a sale of [] aircraft, out of [] ordered, to ACA in May 1997. In its response to Question 40, Canada states that the credit rating for ACA at the time of that transaction was []. Thus, ACA's credit rating had apparently [] over the course of a year.

[34] WT/DS46/RW, Annex I-2, para. 40.

106. The other details of this transaction are not entirely clear. While Canada stated in its response to Question 14 that IQ only provided an equity guarantee, from the chart titled "Détails du Financement" in Canadian Exhibit 64, it appears that Air Nostrum made a [] downpayment, with the remainder of the transaction financed as debt by []. To the extent that Canada financed [] per cent of the transaction, this is clearly inconsistent with the terms of the *OECD Arrangement* limiting the amount that may be financed to 85 per cent of the transaction.

107. At this point I would note that the involvement of Canada Account, and the apparent approval of the transaction in December 1997, suggest that Canada may not have been entirely accurate when it told the previous *Canada – Aircraft* Panel that Canada Account was only involved in two export transactions in the civil aircraft sector during the period January 1995 through June 1998, involving Dash turboprops sold to [] and [].[35]

108. Québec also provided a guarantee of [] per cent of the amount financed. The summary of the transaction provided by Canada in Canadian Exhibit 64 describes this guarantee by CQC as a "garantie du gouvernement." The summary further states that the portion guaranteed by Québec would be subordinate to the portion financed by EDC ("SEE" in the French acronym).

109. The Canada Account portion of the financing appears to have been at a [] per cent interest rate – []. The CQC and EDC portions of the financing were at [] per cent. A simple weight-averaging of these three portions according to the percentage38 Tw (sang) Tj 0 6g

114. Brazil explained in its answer to Panel Question 51 that it considers the terms of the Kendell transaction to be below market. I will not repeat those details, except to point out that we do not know the interest rates at which the other banks participated in the transaction. Usually, when an export credit agency is involved in a transaction, it is the price maker, not the price taker. I would also refer the Panel to Exhibit 65, which shows that in June 1999 – the month in which EDC approved the financing – Kendell's spread, at [] basis points, was [] than every airline except [] and []. Moreover, I would note that EDC based its financing in part on a comparison between Kendell and ACA. However, as Brazilian Exhibit 65 shows, EDC's financing for Kendell was at a [] spread than [] were trading in that month. Kendell's financing was also at a [] rate than the spread estimated in Exhibit 66.

115. Finally, I would note that EDC's spread for Kendell is [] than the spreads at which similarly-rated [] were trading in June 1999. As the graph in Exhibit 68 shows, those [] were trading at over [] basis points above the US T-bill in that month.

6. Air Littoral

116. Canada has stated that it financed the sale of [] aircraft, out of a total of [] ordered, to Air Littoral, a French regional airline, in 1997. Canada states in its response to the Panel's Question 14 that IQ actually provided an *equity* guarantee for this transaction. However, the documentation provided in Canadian Exhibit 62 suggests that CQC provided a loan guarantee of [] per cent (on the "prêt senior") at a fee of [] per cent for this transaction.

117. Canadian Exhibit 62 indicates that [] per cent of the transaction was financed by unspecified banks at a rate of LIBOR [] basis points, which is very roughly equal to T-bill [] basis points. Brazil notes that according to Canada's response to Question 40, the credit rating for Air Littoral at the time of the transaction was [], which is well below investment grade. Under Canada's standard, and prevailing [], we would expect the market to finance this deal, if at all, at a rate of at least T-bill plus [] basis points. At a minimum, it is evident that Air Littoral would not have attracted equity investors absent the Canadian guarantee.

7. Mesa Air and Midway Airlines

118. Finally, I will briefly discuss two companies, Mesa and Midway, to which Canada – through either IQ or CQC – provided equity and/or loan guarantees. Canada's response to Question 14 and Canadian Exhibit 60 indicate that Mesa obtained both a loan guarantee and an equity guarantee. While the pricing for these guarantees was [] per cent, Canada has not produced any evidence to show how it determined these fees were at market rates.

119. Canada states in its response to Question 14 that it provided an equity guarantee for up to [] per cent of the Midway transaction. The documentation provided in Canadian Exhibit 61, however, suggests that CQC also provided direct financing for [] per cent of the deal, with the remaining [] per cent being raised through an EETC issue.

VII. Conclusion

120. Mr. Chairman, for the reasons stated in this and previous submissions, Brazil requests the Panel to find that support to the Canadian regional aircraft industry through Investissement Québec and EDC's Corporate and Canada Accounts constitutes prohibited export subsidies, both "as such" and "as applied."

121. In my statement today, we have included considerable argument and analysis regarding the application of these measures in particular transactions. We would have preferred to present this

Collateral	**Class**	**Amt**	**Ratings**	**15/May 1998**
Atlantic Coast 1997-1	A	58	A2/A–	125
6 CRJ-200Ers	B	25	Baa2/BBB	140
8 Bae J-41s	C	23	Ba2/BB-	
Issued 9/19/97	D	6	B1/BB-	
(144A–no reg rights)				

The resulting spread for this transaction would be:

$$\frac{58*125 ? 25*140}{58 ? 25} = 130$$

(c) revised copies of the graph provided as the second page of Exhibit Bra-68 ([]), to which Brazil has added pointers marking the spreads for the transactions for which Brazil referred to this exhibit.

(d) a disk containing Exhibit Bra-68 and the source data used to generate that chart. Exhibit Bra-68 is presented in a power point file titled **bloomberg.ppt**. Both the charts presented in this exhibit and the underlying data used to create it are contained in a zip file on this disk titled **bloomberg.zip**, which contains extensive data obtained from Bloomberg's databases. These data consist of daily data for both the 10-year US Treasury Bills and the [] for each different credit rating notch. Brazil used the Bloomberg data to plot the graphs in Exhibit Bra-68 based on information in Canada's answer to question 45 and information contained in an EDC memorandum dated 18 January 1999, provided in Exhibit Cda-59, which contained information regarding Canada's [] for certain points in time. Brazil used Canada's definitions to plot the curve for all Bloomberg data for the period 1 January 1996 – 27 July 2001, as follows:

$$\text{Notch} - (\text{Spread})_t = (\text{Market Yield})_t - (\text{10-Year T-Bill})_t ,$$

Thus, for each notch (AAA, AA+, and so on), Brazil computed the spread at a given date t as the difference (in terms of basis points above the 10-year US T-bill) between the Market Yield for that specific notch and the 10-year US T-bill Yield for that particular date. In accordance with US Federal Reserve Bank practice, Brazil plotted the graph in Exhibit Bra-68 based on weekly data for each Monday, and has provided the entire dataset in the attached disk.

(e) a soft copy of Exhibit Bra-69 is contained in the file **eetc.xls**, which, as described above, also contains Exhibit Bra-65. Exhibit Bra-69 was generated using the same source data used to generate Exhibits Bra-65 and -68.

ANNEX A-14

RESPONSES OF BRAZIL TO QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(8 August 2001)

Questions to the Parties Following the Second Meeting of the Panel - 8 August 2001

Both parties

54. In situations in which there are several commercial transactions, at a range of prices, how does one determine the "market price"?

Determining market price in situations in which there are several commercial transactions, at a range of prices, can be difficult. Fortunately, that is not the situation facing the Panel. The "market pricing" at issue here is not the *sales price* of an aircraft, but the price of the *financing terms* available from commercial sources to support sales of regional aircraft. Thus, the market benchmark against which Canada's financing must be compared is not the price for the transaction, but rather, in the words of the first *Brazil – Aircraft* Article 21.5 Panel, "the interest rates in the marketplace for regional aircraft,"[1] or, in the words of the Appellate Body, "where the net interest rate applicable to the particular transaction stands in relation to the range of commercial rates available."[2] Indeed, Canada itself has also recognised that the relevant market is that for financing terms rather than price terms, stating that "EDC offers financing at market rates by *setting the interest rate payable* to the borrower to reflect risk, in accordance with market principles."[3]

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Brazil – Aircraft

? Embraer []; []. For the same amount financed, this discrepancy will necessarily mean that the borrower under the Canadian transaction will pay significantly lower semi-annual payments than it would under the Embraer Canadian transaction.

The offers were clearly different, beginning with the number of aircraft offered. Assuming that it is theoretically possible for such different offers to be "comparable" or "equal" in an economic sense, the burden rests on Canada, the Member claiming comparability or equality to prove it. Canada has not done so. All it has offered is the contractually-mandated statement of Air Wisconsin, after the fact, that the Bombardier/EDC offer, "viewed in its entirety," was "no more favorable" than that offered by Embraer.[5] This statement does not explain how Air Wisconsin 'viewed' the two offers in "their entirety" or why the Bombardier/EDC transaction, with a different value from the Embraer offer and covering very different aircraft, was "no more favorable" than the Embraer offer.[6]

Moreover, the statement does not address the issue before this Panel – whether the *financing terms* of the two transactions were economically equivalent. It also does not address the larger question, which the Panel would face were it possible to answer the first question in the affirmative. That question is whether it is even permissible for an export credit agency to get into a bidding war, in alliance with a national manufacturer/seller, to compete with a private manufacturer/seller who is offering its own financing to support the sale of its goods. Brazil submits that such bidding wars are impermissible, and will only promote a "race to the bottom," at the expense of free and open competition. Of course, an ECA may legitimately offer support that is eligible for the safe haven of item (k) of Annex I. The support Canada offered, however, does not qualify for this safe haven since it exceeds the 10 year maximum term established by the *OECD Arrangement.*

Brazil

57. Brazil has expressed concern regarding the use of indices of general indus trial bonds. In particular, Brazil has asserted that such ratings do not take account of the fact that there may be different risks involved in an airline company as opposed to an industrial company. Why would such different risks not be dealt with by the fact that companies are rated, so that if an airline company is higher risk than an industrial company, it will typically be rated lower?

Brazil believes that the utility of indices of general industrial bonds as a proxy for identifying market rates for financing of regional jet transactions is limited by several factors. First, the [] general industrial corporate bonds represent simple averages at which bonds issued by a wide variety of companies in a wide variety of industries are trading at a given point in time. While bonds issued by airlines may be included in the calculation of this average, the average itself does not reveal whether bonds issued by a particular sector should be valued above or below the average at a particular point in time.

Second, there are substantial differences in liquidity between the average industrial spreads and a bank loan financing a regional jet purchase. The industrial spreads are based on thousands of bonds being traded in huge volumes (with daily trading volume estimated at $10 billion) by traders around the world each day. A bank loan to finance a particular purchase of a regional jet, on the other hand, is an isolated transaction, much less liquid, requiring much greater and more immediate assumption of risk by a lender than the lender would experience buying and selling general industrial bonds.

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[5] Exhibit Cda-2.

[6] Brazil has previously explained that the Air Wisconsin statement is of little value because Air Wisconsin was contractually required by Bombardier to make this declaration. *See* Brazil's Response to Question 34, 6 July 2001.

Third, general industrial bonds do not accurately reflect the spreads for industry sectors that may not normally be publicly rated or issue corporate bonds, such as many airlines that purchase regional jets. Moreover, the different risks between airline companies and industrial companies are not necessarily reflected in the different ratings of the companies. As noted above, the broad industrial averages are simply averages. A major airline rated A-, such as Southwest Airlines, may trade at a different spread than, for example, a major computer company with the same rating. This difference in spreads reflects differences in the market estimation of the prospects for each industry, the nature of the collateral securing each bond, competitiveness within each industry, and the manner in which the bonds are structured within each industry. These factors are reflected to some extent within the ratings, but are largely left to the discretion of the market. Put simply, spreads change a lot more frequently than do credit ratings. In the event of a change in the performance of a particular bond issuer or its industry, the market will react much more immediately than will the credit ratings agencies. The result will be a discrepancy between the spreads at which similarly rated companies in different industries may trade.

The market agrees that the general industrials curves do not reflect the peculiarities of the regional airlines industry. For example, in a report on EETCs, Salomon Smith Barney ("SSB") states that "EETCs trade at a considerable premium compared with comparably rated generic corporate bonds."[7] SSB further states that "… investors demand a spread premium for EETCs because of their close link with the highly volatile and cyclical airline industry. The overall credit profile of the airline industry is considerably lower than the average credit profiles of the market at large. … Aside from the low credit ratings of most airline EETC issuers, we believe that the market demands a credit-related premium because of the airline industry's historically high degree of trading volatility. Furthermore it doesn't help that the airline sector has been a chronic underperformer in the equity market."[8] In addition, SSB notes that "… some investors do not perceive this sector to be particularly liquid, or at least not as liquid as other corporate sectors."[9]

SSB's analysis supports Brazil's and the market's views that companies with the same credit rating will not necessarily enjoy the same spreads when issuing papers in the bonds market. Aside from the obvious fact that a loan differs radically from a corporate bond or from an asset backed security, the airline sector as a whole will normally enjoy much higher spreads than other industrial sectors. In other words, even if the general industrials curve could be used as a benchmark for the pricing of loans, a bank loan to an airline should be priced with a "considerable premium" over the curve value. EDC's pricing strategies do not give any consideration whatsoever to these particularities of the airline industry, which are even more acute for regional airlines than for the large aircraft sector.

Moreover, the similarity in ratings does not in itself mean that companies will obtain financing at the same spreads for particular transactions. Contrary to paragraph of 45 of Canada's statement, and notwithstanding its name, Southwest Airlines is a major airline with revenues of $5.6 billion in 2000 and a fleet of over 350 Boeing large jets and no regional jets.[10] This is a substantially different company from Atlantic Southeast Airlines (ASA), which had revenue of $410 million in 1998.[11] Southwest is currently rated A- by Standard & Poor's.[12] Assuming that ASA,

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[7] Salomon Smith Barney, *The ABCs of EETCs – A Guide to Enhanced Equipment Trust Certificates*, 8 June 2001, page 37. Pages 36-47 of this report are attached as Exhibit Bra-71.

[8] *Id*., page 46.

[9] *Id*.

[10] http://www.southwest.com/about_swa/press/factsheet.html.

[11] http://www.rati.com/airlines/AirlineFinance. 1998 is the most recent year for which information regarding ASA is publicly available.

[12] Exhibit Bra-67.

with less than one-tenth of Southwest's sales revenues,[13] was [] by EDC, this does not mean that the market would finance a sale of [] regional jets to ASA at the same rates as it would finance a sale of the same size to Southwest.

Brazil does not mean to suggest that indices for industrial bonds provide no guidance whatsoever as to the likely financing rates for particular bank-financed regional jet transactions. Indeed, R

Submission and which Canada discussed at the first meeting of the Panel on 26 June 2001. At that Panel meeting, Canada interpreted the EETC spreads as showing that "the financing spreads required from airlines purchasing regional aircraft *far exceed* the US dollar CIRR. Even the *highest rated* US airlines, such as American, are *routinely* required to pay interest rates *significantly greater* than the CIRR."[15] Canada's analysis in this paragraph is identical to and validates the analysis Brazil provided to the Panel on 31 July 2001, just one month later.

58. What proportion of Embraer export sales of regional aircraft have not involved BNDES and / or PROEX support?

Approximately [] per cent of Embraer's export sales of regional jets to date have involved neither BNDES nor PROEX support. Brazil notes that it has not committed new PROEX support for any transactions since 18 November 1999.

59. Brazil has argued that, in considering whether or not a benefit is conferred by Canadian support, the Panel should also consider the possibility of benefit to Bombardier. To what extent is the benefit to Bombardier different from the benefit to its customers? Could there be a benefit to Bombardier in the absence of any benefit to its customers?

Yes, there could be a benefit to Bombardier even in the absence of a benefit to its customers. The Air Wisconsin transaction provides an example of how this might occur. An extremely important consideration for prospective aircraft purchasers is the monthly cost of the aircraft. In general, this cost is composed of the amount required to amortise the principle of the loan and the interest on the

In any event, Brazil notes that this case is about Canadian subsidies that provide Bombardier with financing terms that it could not otherwise obtain in the commercial market for financing. This financing confers a benefit on Bombardier by enabling it to sell more aircraft, as in the Air Wisconsin and other transactions.[16]

60. In response to Question 25 from the Panel, Brazil asserted that it is seeking findings in respect of specific EDC / IQ transactions. Is that still Brazil's position?

Yes. Brazil has challenged three Canadian measures or programmes – EDC (Corporate Account), Canada Account, and Investissement Quebec – "as such" and "as applied." In order for Brazil to prevail on its "as applied" claims,enged thre

61. If one assumes that the second Embraer offer to Air Wisconsin was not officially supported, and that the offer was available in the market, how would the Canada Account offer to Air Wisconsin confer a benefit on Air Wisconsin?

Canada has provided government support that it claims "matches" Embraer's offer to Air Wisconsin. However, Canada's offer to Air Wisconsin differs in a number of important respects from Embraer's offer. (*See* response to Question 56, above). To take simply one element, Canada has provided a [] per cent government equity guarantee to "match" []. Canada's is the better guarantee.

In addition, Canada's financing is for [] years with an average life of [] years, against []. Thus, Canada's official financing terms are on their face better that those offered by Embraer.

Canada claims that Embraer's offer is superior in some respects (e.g., amount financed) but the degree to which superiority in one area should be weighed against inferiority in another has not been established by Canada. Since Canada is the Member claiming these non-identical offers are equal, it is Canada's burden to prove that this is the case. When a Member provides government support to match a non-supported offer, and when those offers are not identical, it is the burden of that Member, not the complaining Member, to show that they are equal, for purposes of establishing that no benefit has been conferred.

Moreover, Canada cannot seriously argue that no benefit was conferred by Canada's offer to Air Wisconsin. First, Minister Tobin himself admitted that Canada's support to Bombardier in the Air Wisconsin transaction conferred a benefit. In his view, Embraer was "able to secure preferential, below commercial rates of interest in providing financing on the sale of aircraft, and that is something that Bombardier cannot do on its own."[19] Thus, Minister Tobin specifically stated that Canada's support to Bombardier conferred a benefit on Bombardier by providing it with something Bombardier was not able to secure on its own in the market: "What we're doing is using the borrowing strength and the capacity of the government to give a better rate of interest on a loan than could otherwise be secured by Bombardier."[20] Brazil notes that while Canada claimed in its answers to the Panel's questions to have followed a pricing methodology designed to reflect market terms, Canada does not claim to have used the same methodologies in the Air Wisconsin transaction. Canada made no effort whatsoever – other than to claim PROEX support was being given by Brazil – to determine whether or not the financing terms it was offering Air Wisconsin actually reflected commercial market terms.

Second, Canada's own statements speak to the fact that Bombardier received a benefit. Canada argues that, in case there was no Brazil government support for the Embraer offer to Air Wisconsin, all Canada did was offer terms available in the market. But Canada's argument misses the point. Bombardier was clearly not able to secure in the commercial marketplace the terms of financing it received through EDC Canada Account. As noted above, the relevant market is the market for financing terms, not the sales price at which the aircraft are available. Canada argues that no benefit was conferred on Air Wisconsin because, with EDC's support, Bombardier matched Embraer's offer. But a benefit was conferred on Bombardier because, by Canada's own admission, Bombardier was not able to obtain such terms of financing in the commercial marketplace.

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[19] Exhibit Bra-21, para. 15.
[20] Exhibit Bra-21, para. 20.

Moreover, a benefit was also conferred on Air Wisconsin because, again according to Minister Tobin, Canada provided a "better rate than one would normally get on a commercial lending basis."[21]

62. The second page of the [] contained in Exhibit BRA-56 refers to []. It also refers to a []. Please confirm that [].

The []. The reference to [] refers to the [].

ANNEX A-15

RESPONSES OF BRAZIL TO ADDITIONAL QUESTIONS FROM THE PANEL FOLLOWING THE SECOND MEETING OF THE PANEL

(15 August 2001)

Additional Questions to the Parties Following the Second Meeting of the Panel

10 August 2001

Brazil

73. In Canada's answer to the Panel's question 56, with respect to repayment term, Canada argues that []. Please comment, taking into account Brazil's statement (in response to the Panel's question 56) that "[]".

Canada appears to have misread the [] that was provided as Exhibit Bra-56. While the faxed copy of the term sheet is a little difficult to read, the second page of the term sheet, under the heading "[]." Canada may have read the figure []." Nevertheless, the statement in Brazil's answer to question 56 that [].

The reference to [].

Please also explain Brazil's contention that under the Bombardier offer there would be significantly lower semi-annual payments. Please demonstrate this, assuming a loan amount of $1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, that 20 per cent of the loan amount would be [].

In its response to question 57, Brazil explained that Canada's [] with a term of [] years and an average life of [] years would result in a lower semi-annual payment than [], for the same amount financed. Brazil determined this by making a sample calculation of the monthly loan factor payable by the borrower under the various financing terms offered by the two parties. Brazil has re-produced this calculation in the worksheet attached as Exhibit Bra-72.

This worksheet shows four calculations of monthly payments based on the Panel's assumptions. Boxes 1 and 2 on the left side of the sheet show the calculation of the total average monthly payment for Embraer's offer, based on the Panel's assumptions of a total value of $1 billion, with $200 million financed as a straight loan [] at a rate of 6 per cent, and the remaining terms as per [], provided as Exhibit Bra-56. The remaining $800 million would be [].[1] The rate remains 6 per cent. This results in a average monthly payment of [] for the $200 million portion of the transaction and [] for the $800 million portion of the transaction. Thus, the total average monthly payment for the $1 billion transaction would be [].

[1] Brazil notes that the Panel's assumption of a price of $200 million [] and $800 million [] values the planes at different prices. This does not, however, affect the outcome of the Panel's hypothetical.

Boxes 3 and 4 on the right side of the sheet show the calculation of the monthly payment for Canada's terms. Box 3 shows the amount calculated for a straight loan of $1 billion, with [] per cent financed at an interest rate 6 per cent, for a term of [] years with a maximum average life of [] years. When structured as a [], this results in an average monthly payment of []. Box 4 shows the calculation when the same transaction is structured as a [], which results in an average monthly payment of []. In both cases, Canada's terms result in a significantly lower monthly payment than Embraer's offer –[] per month less in the case of Canada's [] option and [] per month less in the case of Canada's [].

Brazil calculated the amounts in Boxes 1 and 3 (the straight loan calculations) using the assumptions stated and the Excel function Goal Seek. Brazil calculated the amounts in Boxes 2 and 4 (the USLL calculations) using the Goal Seek function and, in order to determine the monthly payment factor, the ABC software programme, which generates a flow of payments that is consistent with the interest rate under the loan and the average life constraint. This software is well known in the market and is used by [] (see Exhibit Cda-70) and others.

ANNEX A-16

Air Wisconsin transaction does not establish that Bombardier's offer, supported by the full faith and credit of the Canadian treasury, was either equal to, or less favourable than Embraer's offer.

Before turning to specific examples of Canada's mischaracterization of Embraer's offer to Air Wisconsin, Brazil wishes to address the eleventh-hour letter solicited by Canada from Air Wisconsin on 7 August 2001 (Exhibit Cda-68). It is worth noting that this letter from Air Wisconsin, which states that "the terms of the financing support" of the two offers were equally favourable contradicts a previous letter, contained in Exhibit Cda-2, which states that Canada's offer was "no more favourable than" Embraer's offer, "*viewed in its entirety*." (Emphasis added.) Embraer's offer "in its entirety," the Panel will recall, includes []. Contrary to what Canada seems to imply in section 7 of its response to Question 62 from the Panel, this [] was not part of the financing terms of the offer.

Given this apparent con

Interest Rate

In response to Question 56 Canada admits that it did not quite understand the interest rates that Embraer offered and that a comparison of this term cannot be made. Specifically, Canada states that it "is not clear what is meant" by "[].'" Yet Canada nevertheless concludes that the interest rate terms of both offers are equally favourable. It is worth clarifying that Embraer's offer of [].

Administration Fee

In its response to Question 56, Canada states that "Canada's offer requires payment of an up-front administration fee equal to [] per cent of the financed amount payable at the time of financing of each aircraft." Canada then intimates that, because "Embraer's offer does not include any administration or similar up front fees," in this respect, Embraer's offer was more favourable to Air Wisconsin than Canada's offer.

Brazil readily admits that [] does not contain every possible fee and term that one would normally expect to find in a contract for the sale of regional aircraft. As Brazil has previously stated, however, the reason for this is simple – Embraer did not enter into a contract to sell aircraft to Air Wisconsin, Bombardier/Canada did. Thus, it is only logical to expect that the terms of Bombardier/Canada's offer to Air Wisconsin are more fully developed than Embraer's. After all, Bombardier/Canada executed a purchase agreement with Air Wisconsin that set forth every conceivable fee and term of the arrangement. Embraer did not execute such an agreement. As Canada itself notes in its discussion under the subheading titled "Security," even though "[]," had Embraer won the sale, such provisions would have been incorporated in the final loan agreements.

Contrary to Canada's assertion, the mere fact that Embraer's offer does not refer to certain terms that likely would have been included in a final purchase agreement does not thus mean that Embraer's offer was more favourable than Canada's. Indeed, as Brazil has previously stated, when the offers are compared as whole, it is clear that Embraer and Bombardier/Canada offered Air Wisconsin different aircraft packages and different financing packages.

Security

In its discussion under the subheading titled "Security," Canada correctly notes that "[]. . . ." Canada admits, however, that had Embraer won the sale, those provisions would have been added to the final loan agreements. Not knowing what those terms would have been, Canada still somehow concludes that those terms would have been "comparable to those included in Canada's offer."

Canada assumes, without any support, that any provisions added by Embraer to the final loan agreements would have been "comparable to those included in Canada's offer." Moreover, even though Canada acknowledges that such provisions would have been included in the final loan agreements had Embraer won the sale, it makes the surprising statement that the absence of those provisions from Embraer's term sheet render Embraer's offer more favourable than Canada's.

Other Financing Support

Under the heading "Other Financing Support," Canada states that, because Bombardier/Canada's offer does not include [] in the event Embraer won the contract, in "this respect the Embraer offer is more favourable to Air Wisconsin." This argument is also flawed.

Embraer indeed offered a []. Contrary to what Canada seems to assert, however, []. Embraer, a private aircraft manufacturer, made an offer at what would likely have been a short-term loss in order to win the contract and develop a new market. What Bombardier did was resort to the Canadian

treasury to beat Embraer's offer. It did not try to beat the offer by securing better financing from a financing institution in the market or providing the financing itself. It did not offer lower financing or price reductions at its own expense. Canadian government support made it unnecessary for Bombardier to make the type of [].[2] Bombardier decided to remove any risk of losing the deal by making sure that it made an unbeatable offer with the support of the Canadian government.

Canada

66. Has the LA Encore programme used by the EDC been adapted for specific EDC considerations, or is it identical to the programme used by Lloyds Bank, Barclays Bank, and ABN-Amro?

Brazil notes that the US Comptroller of the Currency has stated that most credit scoring models are either "statistical" systems or "expert" systems.[3] A statistical system is one that relies on quantitative factors that are indicators of default, while an expert system is one that "attempts to duplicate a credit analyst's decision making."[4] The Comptroller of the Currency describes LA Encore as an "expert" type of system.[5] Thus, LA Encore requires that its operator use qualitative or subjective factors to determine credit ratings.

In its response to this question, at paragraph 5, Canada admits that EDC has customised LA Encore to take into account these qualitative or subjective factors, or to "reflect EDC's own corporate risk methodologies." Canada provides no information on how this was done other than to say that it takes into account a database of "more than 900 S&P rated industrials." Canada asserts that its customisation has been reviewed by external consultants, but Canada has still not provided any precise information regarding the subjective factors used in obtaining LA Encore ratings.

Nevertheless, based on Canada's answer, it appears that EDC does not make any attempt to consider issues particular to the aircraft sector in general, or specifically the regional aircraft sector, in developing its ratings. As Brazil explained in its response to Question 57, there are several reasons why the average spreads for general industrials may not be applicable to the regional aircraft sector. EDC's customised LA Encore system seems to eschew any consideration of those factors and, as discussed in more detail in Brazil's comments on Canada's submission of 13 August 2001, produces ratings that are completely at odds with those published by Standard & Poor's.

Brazil refers the Panel to the 20 August 2001 Comments by Brazil on Canada's Submission of 13 August 2001 for a more detailed analysis of the flaws of the LA Encore programme as used by EDC.

67. With reference to paragraph 5 of Canada's oral statement of 31 July 2001, please identify the "strong evidence" of Brazilian Government support for Embraer's offers to Air Wisconsin.

In its response to Question 67 Canada repeats previous statements relating to the evidence it allegedly has that Embraer's offer to Air Wisconsin was supported by the Brazilian government. All those previous statements and the Canadian response to Question 67 can be summarized as follows:

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[2] *See* Exhibit Bra-56 [ ]. Pursuant to Article 16 of the Panel's Working Procedures, Brazil requests that the confidential, bracketed information included in this footnote and the above paragraph be excluded from the version of the submission attached to the Panel Report.

[3] *Rating Credit Risk – Comptroller's Handbook, Section A, Assets,* Comptroller of the Currency, Administrator of National Banks, April 2001, available at http://www.occ.treas.gov/handbook/S&S.htm.

[4] Id.

[5] Id.

(i) Canada does not believe that Embraer could have provided the terms of financing it offered without support from the Brazilian government; (ii) Canada relies on statements by Air Wisconsin and Bombardier officials that Embraer "expected" to secure the support of the Brazilian government; and, (iii) Canada purports to have identified some "general pattern" of conduct by Embraer that Embraer must have followed in the Air Wisconsin transaction. None of this is "strong evidence." In fact, none of this is reliable evidence at all.

Canada itself begins its response by admitting that the "strongest evidence" of what Embraer's offer involved – [].

It is worth noting that Canada's assertions contradict its own evidence. Canada has submitted information that its own terms of financing in five transactions varied between [] and [] years and has argued that those terms did not confer a benefit.[6] Similarly, Canada has stated that "it has, on occasion, provided export credits, on commercial terms, at interest rates below the CIRR."[7] Thus, such terms are not necessarily below the market. Either way, however, Canada did not merely meet the terms of Embraer's offer: []. Nor did it merely meet the market. But even assuming, *arguendo*, that Canada did meet the terms of Embraer's offer or the market, it still conferred a benefit on Bombardier, providing to Bombardier terms that Bombardier was not able to secure by itself in the market.

Canada makes much of the [] declaration and of its new Exhibit Cda-68.

Government support. This is pure speculation on the part of Canada, not "strong evidence." Neither Brazil nor Canada can say whether or not [] was available or would have been available to Embraer, or whether Embraer would have changed its practice and made an exception in this case, where it was making an exceptional effort to capture a sale.

Canada is constructing what it refers to as "strong evidence" on the basis of the assumption that [] was not available. There is no evidence to support this assumption. In addition, Canada argues that Embraer could not have intended to finance the Air Wisconsin offer directly. As Brazil pointed out in its response to Questions 31 and 32 from the Panel, one can speculate what Embraer hoped to do or would have done, but this is certainly not "strong evidence."

Third, even if Canada's arguments about some general practice of Embraer to rely on government support had merit, this would be no more than circumstantial evidence about Brazilian government support in any specific transaction, such as the Air Wisconsin transaction. It would not be "strong" evidence.

Fourth, Canada's assertions regarding Brazilian Government support "in the context" of the campaigns for the sale of regional aircraft to SA Airlink and Japan Air Systems are factually incorrect. There was no support whatsoever from either PROEX or BNDES in the SA Airlink transaction, nor has there been any commitment for any support of any kind made to Embraer by either PROEX or BNDES in the JAS offer.

Finally, Brazil would like to make a very important, systemic point. Canada's approach to this issue in general, and Canada's response to Question 67 from the Panel, in particular, are based on

offer involved Brazilian Government support. Canada had to "make every effort to verify"[10] that Embraer's offer involved government support before it supposedly "matched" it, yet it did not even attempt to contact Brazil. Now, Canada essentially claims that it has made a *prima facie* case because [], and because Embraer previously "routinely" obtained Brazilian Government support. None of these assertions can withstand scrutiny. Canada, therefore, has not met its burden of proving its affirmative defence. There is no "serious" evidence that Brazil provided support to Embraer for the Air Wisconsin transaction and there can be no such evidence because Brazil neither provided nor offered support.

68. Article 25 of the IQ Act refers to "export" activities. Is the term "export" defined in the IQ Act, or in some other legislative instrument? If so, please provide the relevant material. Does the term "export" mean export outside of Québec, export outside of Canada, or both?

The term "export" is normally interpreted to refer to goods or services "sold by residents of one country to residents of another in return, usually for foreign exchange,"[11] or "to carry or send abroad."[12] Brazil understands that the Canadian courts have also interpreted "export" to refer to the transfer of goods outside Canada rather than between the Canadian provinces. Thus, the Supreme Court of Canada has stated that:

> Generally speaking, export, no doubt, involves the idea of a severance of goods from the mass of things belonging to this country with the intention of uniting them with the mass of things belonging to some foreign country. It also involves the idea of transporting the thing exported beyond the boundaries of this country with the intention of effecting that.[13]

Similarly, courts of Ontario have determined that "export" refers to "export outside Canada," stating that:

> "To export," in commercial usage, means to send out commodities of any kind from one country to another. The primary meaning of the words is "to carry out of" but one does not speak of "exporting" goods from Toronto to Montreal, for instance, although in the course of the voyage the vessel might pass outside the limits of Canada.[14]

Thus, it appears that the Canadian courts apply the standard definition of the term. Canada admits that the term is not defined in its legislative instruments. Accordingly, the Panel should assume that the standard definition prevails.

Canada's reference to Decree 572-2000, which was issued under the IQ Act, is equally unavailing. The fact that the drafters of the Decree considered it necessary to define "export" to refer -t of Canada hi

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subsidy and claims that, as a result, the subsidy is not contingent on export, many small, partial domestic eligibility designations are likely to follow rapidly. Such an outcome would be inconsistent with the letter and the spirit of the SCM Agreement.

69. Could IQ Decrees 572-2000 and 841-2000 apply in principle to financing regarding sales of Bombardier regional aircraft?

Brazil disagrees with Canada's statement that "Decree 841-2000 could not apply to financing of Bombardier regional aircraft because it applies only to small enterprises." Canada fails to support this assertion. Canada points to no provision of Decree 841-2000 restricting the application of the Decree to small enterprises only.

In fact, nothing in Decree 841-2000 suggests that its application is restricted to small enterprises. The Decree approves a "Programme for Financial Assistance to Enterprises." Section 1 of the Programme, under the rubric "Objectives," states that the objective of the Programme is to promote the economic development of Quebéc by providing financial assistance to enterprises that are engaged in commercial activities ("en accordant une aide financière aux entreprises qui exercent une activité commerciale"). There is no restriction as to the size of the enterprise.

Further, Section 2 states that the assistance is provided for the purpose, *inter alia*, of realization of investment projects, technological innovation, development of markets, etc. Again, there is no restriction relating to the size of the enterprise. Brazil also notes that the definition of the term "development of markets" (Section 10 of Annex II of the Programme) includes development of new markets outside of Quebéc, the promotion of exports to existing markets, the financing of contracts, and the provision of bank guarantees, activities that are all quite relevant to the operations of Bombardier.

On the other hand, there are provisions of the Decree suggesting that it is not restricted to small enterprises. For example, Section 19 of the Programme states that the maximum term of the financial assistance provided by Garantie-Quebéc is 10 years; however, the maximum term is 15 years with respect to *major projects for the development of markets* ("projets majeurs de développement de marchés"). It is hard to reconcile that provision with the assertion that the assistance is provided to small enterprises only.

Further, certain provisions of the Programme address situations where the amount of the

adopted.[15] It is hard to explain why, given the adoption only a month earlier of a decree that explicitly targets small enterprises, Decree 841-2000, which provides no restrictions as to the size of the recipients of the assistance, should be interpreted to apply to small enterprises only.

Canada's response with respect to Decree 572-2000 is equally unpersuasive. Decree 572-2000 promotes investment and employment in Quebéc by allowing IQ to provide financial support to encourage companies to engage in investment projects and exportation and to promote the emergence of new projects (Section 1, "Objectives"). The Decree specifically envisages financial assistance, *inter alia*, to investment projects over $10 million (Section 6(a)) and the provision of credits and loan guarantees to buyers outside of Quebéc for the purchase of goods and services. Canada admits in its response that this measure could be used to finance the sale of Bombardier aircraft but asserts that Decree 572-2000 is "not well suited for financing regional aircraft sales" because of "the Quebéc content limitation and other restrictions."

As Canada notes, the Quebéc content limitation requires that a loan guarantee does not exceed 75 per cent of the Quebéc content of the products exported. Canada does not explain, however, why this limitation makes the Decree "not well suited" to financing Canadian regional aircraft. Canada does not specify what the "other restrictions" are that make the Decree "not well suited" to financing regional aircraft. Finally, Canada states that the Decree has not been used to finance regional aircraft. While this may be so, the Decree can be used to finance regional aircraft in the future.

[15] Décret 594-2000, 17 mai 2000, Concernant la mise en place du Programme de financement des petites entreprises (Exhibit Bra-74).

70. Canada has informed the Panel that equity guarantees have been provided by engine manufacturers such as Rolls-Royce, GE, and Pratt & Whitney. Is Canada aware of other instances where equity guarantees have been provided in respect of aircraft transactions? For example, are EETCs packaged with equity guarantees? If there is no market for equity guarantees outside of IQ and engine manufacturers, how should the Panel determine whether or not the equity guarantees provided by IQ confer a benefit? Is Article 14(c) of the SCM Agreement relevant in this regard?

Canada does not directly dispute Brazil's argument, in its statement to the Panel on 31 July, that equity guarantees are not available in the market. Nor did Canada dispute that statement and provide any contrary evidence when it should have done so – in its rebuttal submission at the second meeting of the Panel. Belatedly, on 8 August, Canada submits information that it claims constitutes "clear evidence of a private sector market for the transfer of risk in a manner *similar* to the guarantees provided by IQ." (Emphasis added). According to Canada, "Financial instruments *similar* to IQ equity guarantees are, in fact, available in the market." (Emphasis added).

Canada does not, however, claim that it would be possible for Embraer to find a guarantee equal to that offered by IQ at any price. More importantly, even for what it claims are "similar" guarantees, Canada is remarkably silent on the price of those guarantees.

Canada's Exhibit Cda-74 purports to show an equity guarantee offered by a private insurer []. But this guarantee is only for [] per cent of the price of the aircraft for [] months, [], or the [] per cent for [] years that Canada provided to Air Wisconsin through IQ. Moreover, even though this was a [] transaction, Canada has deleted from the Exhibit the premium paid for the insurance. Thus, there is no way to determine how the premium charged for this guarantee compared to the apparent [] per cent premium charged by IQ.

This document, which is dated 21 February 2001, was obviously available to Canada prior to the preparation of its submission to the Panel. It is unfortunate that Canada saw fit not to submit this document as an exhibit to its first or second written submissions, as that would have given the Panel and Brazil an opportunity to discuss it at a meeting of the Panel and, perhaps, to ask Canada about the premium.

Canada claims that its Exhibit Cda-75 "shows that aircraft manufacturers can create innovative financing mechanisms centered around risk and remuneration." No doubt, but this Exhibit, too, covers only an apparent [] per cent [], and does not disclose the cost of that guarantee.

Canada's Exhibit Cda-76 consists of letters from two insurance brokers claiming that there is a well-established market for equity guarantees. But apart from their claims, they offer no evidence to contradict Brazil's Exhibit Bra-50 to the contrary, and, moreover, they do not mention premiums for the guarantees.

Finally, Brazil would note that none of these purported equity guarantees discloses the *quality* of the guarantee offered. The Panel will recall that Embraer faced two difficulties in its equity guarantee competition with Canada: (1) the fact that Canada offered a [] per cent guarantee to []; and (2) the fact that Québec's superior credit rating gave its guarantee more value to the equity investors than did Embraer's. To show that Canada merely "matched" Embraer's offer, Canada would have to prove that, for the same premium Québec received, Embraer could have [] from the market that would have been of equivalent value to the equity investors. Canada has not done so.

71. With reference to paragraph 105 of Brazil's oral statement of 31 July 2001, please clarify the dates of the Air Nostrum transaction.

Additional Questions to the Parties Following the Second Meeting of the Panel - 15 August 2001

74. Please comment on Brazil's contention (in response to Question 56) that under the Bombardier offer there would be "significantly lower semi-annual payments" than under the Embraer offer. Please calculate the amount of semi-annual payments for both offers, assuming a loan amount of $1 billion and an interest rate of 6 per cent for both offers. Please also assume, in the case of Embraer's offer, [].

Canada's answer shows that the financing terms of Embraer's offer and the offer by Bombardier/Canada are not equivalent. As Brazil understands the Panel's question, the purpose of the hypothetical is to demonstrate whether the financing terms of the two offers are different. Canada's conclusion that "it is impossible to directly compare semi-annual payments under the two offers on the basis of the Panel's assumptions" in effect is an acknowledgement of the fact that Embraer's offer and the offer by Bombardier/Canada are different. A further acknowledgement of this fact are the results of the calculations provided by [] in its model []. As Canada itself points out, the model shows "very different repayment profiles for the two offers." This completely contradicts Canada's previous position that the financing terms of the two offers are equivalent. Moreover, in its response to this Question Canada has failed to rebut Brazil's arguments that the semi-annual payments under Bombardier's offer would be significantly lower than those under Embraer's offer.

75. Relating to Canada's answer to panel question 67, is Canada of the view that the showing of the "possibility", "probability" or "expectation" of the future Brazilian government support would be sufficient to satisfy a legal element of "official support" under the OECD Arrangement in respect of "matching" provisions?

Canada acknowledges that Article 53 of the *OECD Arrangement* requires a Participant to "make every effort to verify" whether official support is involved in an offer that that Participant seeks to match. Canada did not make "every effort to verify" whether official support from the Government of Brazil was involved in Embraer's offer to Air Wisconsin. Making "every effort" would have involved actually asking Brazil. Had Canada simply asked Brazil, it would have discovered that neither Embraer nor Air Wisconsin received Brazilian government support.

Canada has stated that asking Brazil whether Brazilian official support was involved in Embraer's offer would have been futile, because "Brazil is, even today, denying its involvement in the offer to Air Wisconsin."[17] This is true. Brazil is "denying" its "involvement in the offer to Air Wisconsin" precisely because there was no involvement, and Canada has provided no evidence to the contrary. Under Canada's logic, it is entitled to make an erroneous assumption because inquiry would have revealed an unwelcome truth. The obligation to "make every effort to verify" would be empty if it only required Canada to seek verification from sources it is certain will give it the answer it wants to hear.

76. In response to panel question 67, Canada states that "it is simply not credible that []." Does this mean that Embraer offered financing terms and conditions that were not available in h

As Brazil has explained above, in its comments to Canada's answer to Question 56 from the Panel, Embraer offered to Air Wisconsin [].[18] Moreover, in its response to Question 31 from the Panel[19] and in its Second Submission,[20] Brazil pointed out that Embraer could have [] for a variety of reasons. The point is, however, that Canada cannot show that Embraer's offer is equivalent to the market.

Canada wants to create for itself a win-win situation. Whether Embraer's offer was supported by the Brazilian government or not, Canada's position dictates that it wins: it either "matched" the offer or did not confer a benefit. Canada simply ignores the fact that, as Minister Tobin stated clearly, the Canadian treasury helped Bombardier offer terms that Bombardier could not otherwise obtain in the market.

[18] *See* Exhibit Bra-56. Pursuant to Article 16 of the Panel's Working Procedures, Brazil requests that the confidential, bracketed information included in this footnote and the above paragraph be excluded from the version of the submission attached to the Panel Report.

[19] Brazil Responses to Questions from the Panel, 6 July 2001.

[20] Second Submission of Brazil, 13 July 2001, para. 106.

ANNEX A-17

COMMENTS OF BRAZIL ON RESPONSE OF CANADA TO ORAL STATEMENT OF BRAZIL AT THE SECOND MEETING OF THE PANEL

(20 August 2001)

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I. Introduction

1. This submission contains Brazil's comments on Canada's submission of 13 August 2001, titled "Canada's Response to New Arguments in Brazil's Second Oral Statement."[1] As previously explained to the Panel, Brazil does not consider that its second oral statement, delivered on 31 July 2001, contained new arguments or information. Instead, at the second meeting of the Panel, Brazil simply applied the evidence concerning the measure of the market provided by Canada in previous statements in these and the *Brazil – Aircraft* proceedings to the information provided by Canada in its responses to the Panel's questions submitted on 26 July 2001.

2. In the short time available between the submission of Canada's data and the second meeting of the Panel, Brazil was able to construct reasonable proxies for the financing terms that would have been available in the market at the time of each of the Canadian transactions at issue. No matter which benchmark Brazil used, Canada's financing was below the market benchmark. In certain instances, Brazil also demonstrated that Canada's financing was provided at rates below the prevailing commercial interest reference rate (the "CIRR") established under the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (the *"OECD Arrangement*

17. At the first meeting of this Panel, on 27 June 2001, Canada continued to rely on the EETC spreads to question the veracity of Brazil's statement regarding the terms of Embraer's offer to Air Wisconsin. Canada asserted that "the financing spreads generally required from airlines purchasing regional aircraft far exceed the US dollar CIRR. Even the highest rated US airlines, such as American, are routinely required to pay interest rates significantly greater than the CIRR when financing aircraft even at loan to value ratios of below 70 per cent [citing MSDW's 10 February 2001 EETC market update, Exhibit Cda-14]."[13] Again, once this analysis is applied to Canada's transactions, Canada disavows the analysis. Nevertheless, the data provided in Canada's Response continues to show that Canada provides financing at rates that do not match the standard of "significantly greater than CIRR" that Canada propounded to the Panel at the end of June. For example, in Brazil's 31 July statement, at paragraphs 73-74, Brazil noted that EDC's 26 August 1998 offer to ASA []. At paragraphs 87-88 of the same statement, Brazil noted that EDC's 12 August 1997 offer to Comair [].

18. Canada correctly notes that Brazil objected to aspects of how Canada used EETCs in the second *Brazil – Aircraft* Article 21.5 proceedings. In paragraphs 31-32 of its 13 August response, Canada quotes from Brazil's comments on Canada's responses to questions in that proceeding. But Canada does not explain the context of Brazil's quoted remarks. In the *Brazil – Aircraft* proceeding, Canada sought to show that Brazil's PROEX III programme, which permitted buydowns of interest rates to the CIRR, thereby permitted Brazil to finance at below market rates. In response to question 18 from that Panel, Canada stated as follows:

> 5. Canada has presented detailed argument and evidence before this Panel at

basis points above the CIRR when, at the same time, its own lending to airlines

the EETCs represent actual market rates on aircraft financing secured by aircraft. In several of the worksheets (see pages 7-10) provided in Annex II, however, the [] are the only factor supporting Canada's claim that its rates are at market. If the broad averages are not considered as representative of the regional jet sector (and Canada has failed to show that they are), Canada's pricing is well below market in each of these cases.

26. Canada has also attacked Brazil for using data from one time period as a comparable for transactions from a different period. As explained above, Brazil's methodology reasonably attempted to account for time factors. Despite this attack on Brazil, Canada itself uses data from one period to justify pricing in another. For example, in Annex II, Canada relies on the [] to support *every* comparison with the exception of the Atlantic Coast Airlines February 1996 and Kendell Airlines August 1999 offers. Canada uses these [] as representative comparisons in charts covering financing offered in July 1996 (a year before the []), March 1998, August 1998, February 1999, and March 1999. This suggests that Canada is simply cherry-picking data it considers favourable to support its own position. In contrast, the advantage of Brazil's use of EETC issues is that it gave Brazil a representative sample of over 30 different issues and over 100 different tranches on which to base reasonable estimates of the market pricing.[18]

D. Canada's Attacks on Brazil's Methodology Are Contradictory

27. Canada's attacks on Brazil's methodology are also contradictory in other respects. For example, Canada states on page 1 of Annex I that there is a "large gap" between the EETC pricing and the pricing from *comparable corporate bond spreads* and the Fair Market Curve spreads" (emphasis added). However, Canada acknowledges on page 1 of Annex II that "there are not many unsecured airline corporate bonds. Moreover, to Canada's knowledge there have been *no corporate*

that Exhibit, the software has "customisation tools" that allow the user to establish its "own credit practices, policy guidelines or internal ratings approach." Further, "[a] powerful set of support tools *makes customisation possible at every level…*" (emphasis added). In fact, the customisation of results is ensured, inter alia, by a "tuner," that allows the user to "reconfigure subjective questions and adjust their impacts throughout the assessment network."[23]

36. Canada's Exhibit 73 provides further evidence of the lack of objectivity of the software. Sections 3.2 and 3.2.1 describe in detail how the user may establish its own "weight rule" and assign different weights to the various parameters it has selected to be examined. Again, Canada has provided no information as to how its own "weight rules" actually work. In fact, this software is so easy to customise that the results obtained with the programme are actually meaningless to anyone outside the institution that uses it. In the words of the expert cited by Canada, Mr. Kumra, "this flexibility generally precludes the outputs of the system from being used outside the organization. The very attributes that allow extensive customization of the knowledge base for specific credit environments prevent two organizations from being able to *objectively* use the measure as a basis for transactions since they cannot use the (differently) customized systems as a common basis for comparison."[24]

37. According to Canada's own exhibits, the LA Encore results obtained by EDC reflect EDC's own methodologies, its own culture, and the risk appetite of an official export credit agency. None of these factors is dependent on the commercial market for financing terms for regional jet transactions. It is no wonder, therefore, that EDC's use of LA Encore can improve the credit rating of an airline company by []. In these circumstances, the Panel should not consider EDC's use of its customised software as in any way supportive of Canada's claim that EDC finances at market rates. The Panel should not only consider particular transactions financed through EDC as violations of the SCM Agreement. It should also hold that EDC's use of the "market window" as such is a violation because the whole "market window" concept is based on significantly inflated credit ratings of the borrowers.

B. EDC's Credit Ratings for Its Customers Are Vastly Overstated

38. In addition to, and because of, LA Encore's fundamental unreliability and subjectivity, the credit ratings assigned by EDC to its various customers are much better than agencies such as Standard & Poor's normally assigns to the airline industry. An analysis of EDC's ratings shows that

Canada (using the ratings for both secured and unsecured debt) and the ratings published by Standard & Poor's for the relevant date.[25] A "+" symbol in the columns headed "Difference" indicates the number of notches by which EDC's customer has a *better* credit rating than the published Standard & Poor's airline for each company. A "-" symbol in those columns indicates the number of notches by which EDC's customer has a *worse* credit rating than the Standard & Poor's rating.

40. This analysis shows that, for example, Canada rated Atlantic Southeast Airlines (ASA) [], in August 1998. In March 1997, Canada rated ASA []. ASA's rating in both cases was []. The significance of this rating can be seen by reference to the spreads for [] for August 1998, provided in Exhibit Bra-68. The first page of this exhibit shows that the spread for an [] with the rating of [] (unsecured) [] was approximately [] bps above the 10-year US T-bill. The spread for [ ] with the rating of [] assigned by Standard & Poor's to American, in contrast, was over [] bps above the 10-year T-bill. Nothing in Canada's response comes even close to justifying these differences, or explaining how or why ASA came to have []. Nevertheless, Canada uses these ratings to provide terms to EDC customers such as ASA that would not apparently be available to Standard & Poor's highest-rated airlines. Canada uses these inflated ratings, in other words, to release EDC from the requirements of the *OECD Arrangement* and to justify its foray into "market window" financing.

41. The story is the same for EDC's other customers. In both March 1998 and February 1999, for example, EDC gave Comair a [].[26] Again, Canada has provided no explanation of why Comair merited []. However, the materials provided by Canada in Annex II to its 13 August 2001 submission illustrate the extent to which Canada's argument depends on these ratings. Page 10 of Annex II shows Canada's comparisons for Comair's February 1999 pricing of T-bill plus [] basis points, and states this was "well above" the market, including bond issues and the []. This may be so only if it is assumed that Comair's rating of [ ] is reasonable. If Comair were given the [].

42. The same contrast exists on page 9 of Annex II. This analysis gives Canada's comparisons for Comair's March 1998 pricing of T-bill plus [] basis points, which Canada claims was "within" market for that period. However, page 9 indicates that EDC's pricing was below all of the comparables Canada itself uses, except for []. Again, if Comair were given the same rating as [], EDC's pricing would be [] in addition to the other indices on which Canada relies.

43. The same analysis holds true for all of the customers for whom Canada has provided information in its 13 August 2001 submission, with the possible exception of Kendell.[27] For [], all the evidence indicates that the credit ratings for these companies are simply not consistent with credit ratings for other airlines in the market, and therefore are simply not a reliable market-consistent basis on which to determine market spreads for financing for these customers.

44. Finally, Brazil notes also that Canada's ratings are much better than the ratings Canada itself has said are normally found in the airline industry. In *Brazil – Aircraft*, Canada noted that as of January 2001, *no* airline had an "A" rating.[28] Yet, as shown in attached Exhibit Bra-73, [].

IV. Specific Transactions

[25] The Standard & Poor's ratings were provided in Exhibit Bra-67.

[26] Comair's rating of [].

[27] Kendell is the only EDC customer in this analysis that obtained a []. Given that the Kendell transaction [], the credit rating assigned by EDC to Kendell may be said to be consistent with Standard & Poor's ratings. Rather than justifying EDC's practices, however, this further illustrates the anomalies in EDC's ratings of []. Brazil's comments regarding the specifics of the Kendell transaction are provided below.

[28] WT/DS46/RW/2, para. 5.36, n. 51.

45. Brazil has shown that Canada's resp

demonstrated that it actually matched competing terms. Even on 8 August, when it provided, in Exhibit Cda-77, a revised version of the documentation regarding Canadian government support for Air Nostrum, Canada failed to provide any documentary information supporting its alleged match. Moreover, as the Panel is aware, Brazil does not consider that recourse to matching maintains "conformity with" the interest rates provisions of the *OECD Arrangement*.

D. Kendell Airlines

51.

55. Canada makes several assertions with respect to IQ support. First, although it continues to insist, in paragraph 111 of its submission, that IQ charges fees for its guarantees, it has provided no evidence of those fees whatsoever with respect to the Air Wisconsin transaction. In fact, Canada has failed altogether to provide documentation for the IQ guarantee to Air Wisconsin similar to that provided in Exhibits Cda-60 through Cda-64 for IQ guarantees to other Bombardier customers. With respect to other transactions for which Canada has shown evidence of a fee,[35] it has only shown the [] basis point "up-front fee," and not the [] basis point "annual fee" Canada claims is also charged.

56.

60. Brazil notes that Canada does *not* deny that CQC provided debt financing support for the Air Nostrum transaction. As noted in paragraphs 106 of Brazil's 31 July statement for the second meeting of the Panel, the "Détails du Financement" chart included with Exhibit Cda-64 indicates that after Air Nostrum's []. The "Sommaire de transaction" included in the same Canadian exhibit states that SDI (now IQ) further guaranteed [] per cent of that "montant financé." With its new Exhibit Cda-77, discussed in more detail in Brazil's comments on Canada's 8 August response to question 72, Canada now states that Canadian government support came in the form of debt financing, with [].

61. Third, in paragraph 112 of its submission, Canada again resorts to the impact of alleged [], this time to rebut Brazil's claim that charging the same fee to recipients of IQ guarantees with varying credit ratings is inconsistent with market practices. According to Canada, [], IQ's risk that any particular purchaser will default is spread across the portfolio of all transactions. [].

62. Even assuming, *arguendo*, [] Canada's argument is without merit. [] and the way in which it [], may very well "greatly diminish" IQ's risk exposure, as Canada argued in its response to question 47. However, as Canada itself emphasized in its response to question 48, []. Those []. When an aircraft purchaser goes to a lender or looks for equity investors with an IQ guarantee, the lender or the investors see the full [] per cent guarantee backed by the superior, A+ credit rating of the Government of Québec. Whatever the effect of a [], Québec's A+ rating confers a benefit on the lower-rated purchasers receiving IQ guarantees, by allowing them to secure more favourable terms for debt or equity.[39] Moreover, charging the same fee for this benefit, regardless of the purchaser's credit rating, is not market-based.

63. Brazil also notes that []. The alleged []. Thus, IQ's risk exposure is not diminished with respect to the remaining [] per cent of its guarantee. Moreover, Finally, [] appear only to apply to IQ equity guarantees, and not IQ loan guarantees.

VI. Conclusion

64. Using Canada's own data and Canada's own methodology, Brazil was able to show that Canada's financing through the challenged programmes is below the market. Canada's attacks against Brazil's data and methodology are therefore groundless. Moreover, Canada has not been able to justify the credit ratings it assigns to its customers and has failed to show that it relies on objective estimates of the market in providing government support. Canada's 13 August response, therefore, fails to rebut Brazil's showing that Canada provides export financing support on below market terms.

[39] *See* paragraph 143 of Brazil's 13 July rebuttal submission, and paragraphs 14-15 of Brazil's 31 July statement for the second meeting of the Panel.

ANNEX A-19

COMMENTS OF BRAZIL ON COMMENTS OF CANADA ON INTERIM REPORT OF THE PANEL

(2 November 2001)

Paragraph 7.18

In its comment to Paragraph 7.18, Canada states that the legal framework under which the Canada Account is operated has "not changed."

Brazil notes that the legal framework under which the Canada Account operates has, in fact, changed since the Panel's decision in the first *Canada - Aircraft* dispute. As a result of that Panel's ruling, Canada enacted a policy memorandum stating that Canada Account support would respect the terms of the *OECD Arrangement*. The Article 21.5 proceedings in that dispute centered on this policy memorandum. Although the Article 21.5 *Canada - Aircraft* Panel found that this policy memorandum did not bring Canada Account into consistency with its obligations under the SCM Agreement, this memorandum is apparently still in effect. Canada provided a copy of the memorandum to this Panel as Exhibit Cda – 50. The Panel should therefore reject Canada's comment.

Paragraph 7.145

Canada's comment to Paragraph 7.145 states that, "In the last sentence, '… Canada assumes that because the Embraer offer was not supported by the Brazilian Government …' should be changed to '…Canada assumes that if the Embraer offer was not supported by the Brazilian Government …'. This would more accurately reflect Canada's argument, which was made in the alternative to Canada's principal position that Embraer's offer was supported by the Brazilian Government."

Brazil objects to this comment and the proposed amendment. In the preceding paragraphs the Panel discusses Canada's argument that Canada had "matched" Brazil's offer in compliance with the *OECD Arrangement*. In paragraph 7.145 the Panel refers to Canada's argument in the alternative: that because Canada's offer was extended on the same terms as Embraer's offer, Canada's offer was market-based. The purpose of the last sentence of paragraph 7.145 is thus not to reflect Canada's doubts on whether Embraer's offer was realistic without the support of Brazil. The word "because" is there to show a cause and effect relationship, a causal link. The point of that sentence is that Canada assumes that an offer not supported by the government is, for that reason alone, market-based. The Panel should therefore reject Canada's comment.

Paragraph 7.152 & 7.316

In its comment to Paragraph 7.152 and Paragraph 7.316, Canada states that, "It is not correct that Canada Account (or Corporate Account) financing is only available for export transactions." Canada now claims that EDC may enter into "'domestic financial transactions' .

. . provided that in doing so, EDC is supporting and developing . . . Canada's export trade and Canadian capacity to engage in that trade and to respond to international business opportunities."

Brazil objects to this comment and notes that Canada chose not to make this argument to the Panel, despite having had ample opportunity to do so. Because Canada has waited until after the release of the Interim Report to present this claim, there is no information in the record supporting Canada's assertion. Throughout the course of this proceeding, Canada has constantly reminded the Panel of the importance of respecting a Member's right to due process. Because Canada's claim regarding EDC's alleged domestic support was not previously raised, Brazil did not have an opportunity to fully litigate the issue before the Panel. Consequently, Brazil's due process rights would be severely compromised if the Panel were to alter the Interim Report to reflect Canada's belated claim. In any event, even if the Panel were to consider this argument (which it should not), the *proviso* in the last sentence of Canada's comment proves that the Canada Account and Corporate Account can only be used to support and develop Canada's export trade. The Panel should therefore

Paragraph 7.392, Footnote 303

Canada's comment on footnote 303 states, in part, that this note "suggests, incorrectly, that Canada failed to provide information when requested to do so by the Panel."

Brazil notes that although Canada's 25 June letter summarily refers to IQ's role, as does page 12 of the attachment to that letter, Canada did not provide the Panel with CQC's "Sommaire de transaction" (Exhibit Cda-106), which provides the details of IQ's involvement, until 31 August 2001, in response to the Panel's 24 August 2001 letter. The Panel should therefore reject Canada's comment.

Paragraph 7.387

Canada's comment on this paragraph states that, "It appears that the last word of the second last sentence, 'excluded', should read 'included'."

Brazil believes the word "excluded," in the sentence to which Canada refers, should be replaced with the word "provided."

Technical Correction

Brazil notes that Canada's exhibits in this proceeding were labelled or referred to as either "Exhibit CDA-XX" or "Exhibit Cda-XX."