**WORLD TRADE ORGANIZATION**

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# BRAZIL – EXPORT FINANCING PROGRAMME FOR AIRCRAFT

## Second Recourse by Canada to Article 21.5 of the DSU

## *Report of the Panel*

The report of the Panel on *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU* is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 26 July 2001 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

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## I. PROCEDURAL BACKGROUND

1.1 On 20 August 1999, the Dispute Settlement Body ("DSB") adopted the Appellate Body Report (WT/DS46/AB/R) and the Panel Report (WT/DS46/R), as modified by the Appellate Body Report, in the dispute

1.9 To examine, in the light of the relevant provisions of the covered agreements cited by Canada in document WT/DS46/26, the matter referred to the DSB by Canada in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.

1.10 The Panel was composed as follows:

Chairperson: Dr. Dariusz Rosati

Members: Prof. Akio Shimizu
Mr. Kajit Sukhum

1.11 Australia, the European Communities, Korea and the United States reserved their rights to participate in the Panel proceedings as third parties.[1]

1.12 The Panel met with the parties on 4-5 April 2001. It met with the third parties on 5 April 2001.

1.13 The Panel submitted its interim report to the parties on 20 June 2001. On 25 June 2001, both parties submitted a written request that the Panel review precise aspects of the interim report. Neither party requested an interim review meeting. The Panel submitted its final report to the parties on 10 July 2001.

## II. FACTUAL ASPECTS

2.1 As described in our original Panel Report[2]

> enough to render financing costs compatible with those practiced in the international market.
>
> Paragraph 1. When financing exports of regional aviation aircraft, interest rate equalisation shall be established on a case-by-case basis, at levels that may vary according to the characteristics of each operation, complying with the Commercial Interest Reference Rate (CIRR) published monthly by the OECD corresponding to the currency and maturity of the operation.

2.5 Article 8, paragraph 2 of BCB Resolution 2799 states as follows:

> Paragraph 2. In the process of analyzing received requests for eligibility [for PROEX III support], the [Export Credit Committee] shall have as reference the financing terms practiced in the international market.

2.6 The other main features of PROEX III remain essentially as they were during the previous Article 21.5 panel proceedings.

2.7 Thus, the maximum financing terms for which interest rate equalisation payments may be made are established by a Ministerial Directive.[5] The length of the financing term, in turn, determines the spread to be equalised: the payment ranges from 0.5 percentage points per annum, for a term of up to six months, to a maximum of 2.5 percentage points per annum, for a term of over nine years and up to ten years.[6] The spread is fixed throughout the financing term.

2.8 PROEX III, like its predecessor versions, is administered by the *Comitê de Crédito as Exportações* (hereafter "Export Credit Committee"), a 13-agency group, with the Ministry of Finance serving as its executive. While day-to-day operations of PROEX III are conducted by the Central Bank of Brazil, all requests for PROEX III support in respect of exports of regional aviation aircraft must be approved by the Export Credit Committee.

2.9 PROEX III involvement in aircraft financing transactions begins when the manufacturer requests a letter of commitment from the Committee prior to conclusion of a formal agreement with the buyer. This request sets forth the terms and conditions of the proposed transaction. If the Export Credit Committee approves, the Central Bank of Brazil issues a letter of commitment to the manufacturer. This letter commits the Government of Brazil to providing support as specified for the transaction provided that the contract is entered into according to the terms and conditions contained in the request for approval, and provided that it is entered into within a specified period of time, usually 90 days (and provided the aircraft is exported, as explained below). If a contract is not entered into within the specified time, the commitment contained in the letter of approval expires.

2.10 PROEX III interest rate equalisation payments begin after the aircraft is exported and paid for by the purchaser. PROEX III payments are made to the lending financial institution in the form of non-interest-bearing National Treasury Bonds (*Notas do Tesouro Nacional – Série I*), referred to as NTN-I bonds. The bonds are issued by the Brazilian National Treasury to its agent bank, the Central Bank of Brazil, which then passes them on to the lending banks financing the transaction. The bonds are issued in the name of the lending bank which can decide to redeem them on a semi-annual basis for the duration of the financing or discount them for a lump sum in the market. PROEX III thus resembles a series of zero-coupon bonds which mature at six-month intervals over the course of the financing period. The bonds can only be redeemed in Brazil and only in Brazilian currency at the

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[5] See Ministerial Directive 374 of 21 December 1999 (hereafter "Directive 374") (Exhibit BRA-3).

[6] See Central Bank of Brazil Circular Letter No. 2881 of 19 November 1999 (hereafter "Circular Letter 2881") (Exhibit BRA-2).

exchange rate prevailing at the time of payment. If the lending bank is outside of Brazil, it may appoint a Brazilian bank as its agent to receive the semi-annual payments on its behalf.

## III. PROCEDURAL ISSUE

3.1 **Brazil** asserts that, during the meeting of the Panel with the parties, while the representative of Brazil was presenting Brazil's oral statement, a member of the Canadian delegation left the room carrying a copy of the confidential written version of Brazil's oral statement. According to Brazil, a member of its delegation later left the room to investigate and found that several persons who were not members of Canada's delegation were sitting in the lounge outside the meeting room reading Brazil's confidential statement. Brazil does not contest that Members are entitled to decide for themselves the composition of their delegations, but considers that they have no right to decide for themselves which documents designated by the other parties as confidential should be treated as such.

3.2 Brazil objects strongly to the alleged disclosure of its confidential statements to the representatives of private parties who were not members of Canada's delegation. Brazil submits that the aforementioned alleged incident is a serious breach of Canada's obligations to respect the rules of confidentiality, including Article 14 of the *DSU* and paragraph 3 of the Panel's Working Procedures. According to Brazil, nothing in the Panel's Working Procedures or the *DSU* authorizes disclosure of confidential documents to persons who are not members of a delegation. Brazil requests that the Panel specifically note this alleged breach of the rules in its Report and that it take whatever other steps it deems appropriate.

3.3 **Canada** explains that it has not given access to Brazil's submissions (including exhibits) and/or statements (including exhibits) in these proceedings to any employees of Canadian regional aircraft manufacturers. Canada notes that it has shared these documents with members of a private law firm retained by a Canadian regional aircraft manufacturer. According to Canada, these individuals have served as advisors to the Government of Canada, form part of Canada's "litigation team", and are subject to a confidentiality agreement whereby they are not to disclose the documents such as those previously mentioned, including to their client. Canada also states that these individuals would not have received any business confidential information if Brazil had filed any in these proceedings.

3.4 In the view of Canada, paragraph 13 of the Panel's Working Procedures recognizes that parties may consult advisors who are not members of their delegations. Canada submits that the only reason why parties should have the responsibility for these advisors in regard to the confidentiality of the proceedings is because a party may share submissions and other documents with these advisors. Canada considers that statements by the Appellate Body in *Canada – Measures Affecting the Export of Civilian Aircraft*[7] and Panel in *Korea – Taxes on Alcoholic Beverages*[8] confirm its view that submissions may be shared with a party's advisors who are not on its "delegation". Canada also notes that, were it otherwise, parties would simply protect their ability to make a full response by greatly expanding their delegations, as is their right.

3.5 The **Panel** notes that, as a factual matter, Canada does not deny that a member of its delegation at the meeting of the Panel with the parties of 4 April 2001 provided a copy of Brazil's written version of its oral statement to people who were not members of its delegation, as notified to the Panel. In fact, Canada acknowledges that it has "shared [Brazil's submissions and statements]

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[7] Canada refers to the Appellate Body Report on

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with members of a private law firm retained by a Canadian aircraft manufacturer".[9] Accordingly, the issue facing us is whether it was permissible for Canada to share Brazil's oral statement and other documents submitted to the Panel with the private law firm in question. In considering this issue, we note that Article 18.2 of the *DSU* provides in relevant part that:

> … Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential.[10]

3.6 In our view, it emerges from this provision that Canada must keep confidential all information submitted to this Panel by Brazil.[11] However, as the Appellate Body has noted, "a Member's obligation to maintain the confidentiality of […] proceedings extends *also* to the individuals whom that Member selects to act as its representatives, counsel and consultants."[12] Thus, the Appellate Body clearly assumed that Members may provide confidential information also to *non*-government advisors.

3.7 We see nothing in Article 18.2 of the *DSU*, or any other provision of the *DSU*[13], to suggest that Members may share such confidential information with non-government advisors only if those advisors are members of an official delegation at a panel meeting.[14] Indeed, paragraph 13 of this Panel's Working Procedures expressly provides that:

> The parties and third parties to this proceeding have the right to determine the composition of their own delegations. Delegations may include, as representatives of the government concerned, private counsel and advisers. The parties and third parties shall have responsibility for all members of their delegations and shall ensure that all members of their delegations, *as well as any other advisors consulted by a party* or third party, act in accordance with the rules of the DSU and the working procedures of this Panel, particularly in regard to confidentiality of the proceedings. Parties shall provide a list of the participants of their delegation before or at the beginning of the meeting with the Panel. (emphasis added)

3.8 It is apparent from the second and third sentences of paragraph 13 of the Working Procedures that the "other advisors" referred to are advisors who are *not* part of a Member's delegation at a panel meeting. It is equally clear to us that paragraph 13 is based on the premise that parties to panel proceedings *may* give their "other advisors" access to confidential information submitted by the other

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[9] Canada's Response to Panel Question 31 (AnnexA-4).

[10] Paragraph 3 of this Panel's Working Procedures also includes the quoted sentence.

[11] This is subject, of course, to the provisions of the last sentence of Article 18.2 of the *DSU*, which allow a party to panel proceedings to disclose to the public non-confidential summaries of the information contained in the written submissions of the other party, if such summaries are requested.

[12] Original Appellate Body Report on *Canada – Aircraft*, *supra*, para. 141 (emphasis added). The Appellate Body made the quoted statement in respect of appellate review proceedings. We do not see, however, why the same reasoning should not extend, by analogy, to panel proceedings.

[13] Contrary to Brazil, we do not think that Article 14 of the *DSU* is relevant to the issue before us. Article 14 focuses on panels and their obligations in respect of confidentiality; it does not address itself to the obligations of the parties in respect of confidentiality.

[14] The following statement by the Panel in *Korea – Alcoholic Beverages* supports this view:

> We note that written submissions of the parties which contain confidential information may, in some cases, be provided to non-government advisors who are not members of an official delegation at a panel meeting. The duty of confidentiality extends to all governments that are parties to a dispute and to all such advisors *regardless of whether they are designated as members of delegations and appear at a panel meeting*. (Panel Report on *Korea – Alcoholic Beverages*, *supra*, para. 10.32, emphasis added)

party.[15] Were it otherwise, there would be no point in requiring parties to safeguard the confidentiality of panel proceedings in respect of such "other advisors".[16]

3.9 On the basis of the foregoing, we are unable to accept Brazil's argument that Canada acted inconsistently with the requirements of the *DSU* or this Panel's Working Procedures by giving advisors not designated as members of its delegation access to information submitted to this Panel by Brazil.[17]

3.10 In reaching this conclusion, we note, however, that, pursuant to paragraph 13 of the Working Procedures, Canada must ensure that any advisors who were not members of its official delegation respect the confidentiality of the present proceedings.

3.11 We note Canada's statement that the members of the law firm which have had access to Brazil's submissions have been part of its litigation team and have served as "advisors" to the Government of Canada. Since no members of a private law firm were part of Canada's delegation to the meeting of the Panel with the parties, the private lawyers Canada says were advising it fall within the "other advisors" category within the meaning of paragraph 13 of the Panel's Working Procedures. It was (and is), therefore, the responsibility of Canada to ensure that those private lawyers maintain the confidentiality of the documents submitted by Brazil.

3.12 Based on Canada's representations, we also understand that the law firm in question has an attorney-client relationship with a Canadian regional aircraft manufacturer. We think that the dual role performed by the law firm -- as advisor to the Government of Canada and attorney for a Canadian regional aircraft manufacturer -- places the law firm in a particularly delicate position as far as the protection of Brazil's submissions, statements and exhibits is concerned.[18] In our view, it is crucial, in such circumstances, that Canada put in place appropriate safeguards to ensure non-disclosure of confidential information.

3.13 Importantly, Canada has represented that the members of the law firm who have had access to Brazil's submissions, statements and exhibits are subject to a confidentiality agreement with the Government of Canada which requires them not to disclose any such information, including to the Canadian regional aircraft manufacturer which is their client.

3.14 Brazil does not contest these facts. Moreover, Brazil has provided no evidence that those private lawyers have disclosed Brazil's confidential documents to the regional aircraft manufacturer which is their client or any other persons who are not advisors to the Government of Canada.

3.15 We agree that maintaining confidentiality in accordance with the obligations of the *DSU* is important. On the other hand, in applying the rules on confidentiality we must be careful not to stifle necessary communication between Member governments and their advisors, as long as appropriate safeguards are in place. In the absence of arguments and evidence to the contrary, we have no basis

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[15] Brazil is correct in pointing out that paragraph 13 does not *expressly* authorize disclosure of confidential information to "other advisors", but, in our view, it does so by implication. We stress, however, that paragraph 13 talks about "advisors" and not other members of the public, such as private parties interested in the outcome of particular panel proceedings.

[16] We note that there is nothing in the other paragraphs of this Panel's Working Procedures to suggest that confidential information may be disclosed to non-government advisors only if those advisors are members of an official delegation to a panel meeting.

[17] It should be pointed out that Brazil did not, in these proceedings, submit any business confidential information.

[18] We recall that Brazil's concern is with the confidentiality of its arguments and statements. Business confidential information, which might require other procedures and safeguards, is not, as already mentioned, involved in this situation.

for questioning Canada's representation that the relevant private lawyers are subject to a confidentiality agreement with the Government of Canada.[19]

## IV. INTERIM REVIEW[20]

4.1 In letters dated 25 June 2001, Canada and Brazil requested an interim review by the Panel of certain aspects of the Interim Report issued to the parties on 20 June 2001. Neither party requested an interim review meeting. As agreed by the Panel, both parties were permitted to submit further comments on the other party's interim review requests. Brazil submitted such further comments on 28 June 2001.

### A. COMMENTS BY CANADA

4.2 **Canada** requests that the Panel complement its description of the facts of this case by adding a reference to the "undisputed fact" that the Export Credit Committee has the authority to waive some of the published PROEX III guidelines. **Brazil** disagrees with Canada's characterization of its position and of the facts before the Panel. Brazil recalls its argument that, while PROEX III support will be considered on a case-by-case basis, Article 8, paragraph 2 of BCB Resolution 2799 imposes a specific affirmative requirement on the Export Credit Committee to ensure that PROEX III support, in addition to meeting the specific criteria enumerated elsewhere, is consistent with the terms practised in the international markets. The **Panel** notes that the issue of Brazil's discretion to waive some of the published PROEX III guidelines, and of the circumstances under which it may do so, is addressed in some detail at various points in our findings, including paras. 5.186–5.188 and 5.159-5.161. We therefore decline Canada's request to include further language on this issue in para. 2.8.

4.3 With respect to footnote 24, **Canada** believes to have established that PROEX III is now
**Brazil**

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5.2 Canada states that it is challenging the PROEX III *scheme* in so far as it relates to the financing of exports of regional aircraft because, no matter how it is delivered, it enables Brazil to continue to grant prohibited export subsidies. Canada is also challenging PROEX III *payments* made in support of regional aircraft exports because payments under PROEX III remain prohibited export subsidies. With respect to its challenge to PROEX *payments*, Canada refers to the original Panel Report in this dispute, which stated that "we understand Canada to be challenging not only specific payments, but more generally the practice involving PROEX payments relating to exported Brazilian

does not contest, that a panel is entitled to review a subsidy programme *per se* for its consistency with the *SCM Agreement*.[26]

5.7 Canada also challenges *payments* under PROEX III, by which it means "the practice involving PROEX payments". Canada has not, however, disputed Brazil's contention that, under PROEX III, no payments have yet been made, nor letters of commitment issued, in respect of exports of regional aircraft. Therefore, and in the absence of specific evidence to the contrary[27], we are not in a position to review the consistency either of individual PROEX III payments in respect of regional aircraft or a "practice" in respect of such payments with the *SCM Agreement*.[28] It is evident to us that, in the absence of *any* payments or letters of commitment under PROEX III in respect of regional aircraft, there is no "practice" that we could review.

5.8 It follows from the foregoing that our task in these proceedings is to examine the consistency with the *SCM Agreement* of the PROEX III programme *per se*, i.e. the legal framework of PROEX III, in so far as it relates to exports of regional aircraft[29].

B. REVIEW OF LEGISLATION *PER SE*

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5.13 For the foregoing reasons, in reviewing whether the PROEX III scheme *per se* is a prohibited export subsidy, our examination will entail a consideration as to whether PROEX III *requires* Brazil to provide subsidies prohibited by Article 3.1(a) of the *SCM Agreement*.

## C. OVERVIEW OF THE PARTIES' ARGUMENTS

5.14 **Canada** considers that PROEX III support in respect of exports of regional aircraft, however it is delivered, is a subsidy contingent upon export performance prohibited by Article 3.1(a) of the *SCM Agreement*. Canada further argues that PROEX III is not in conformity with the interest rates provisions of the *OECD Arrangement on Guidelines for Officially Supported Export Credits* (hereafter the "*OECD Arrangement*") and thus does not qualify for the "safe haven" in the second paragraph )of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the"

within the meaning of Article 1.1 of the *SCM Agreement*. Canada adds that, if Embraer's customers

even if the CIRR did accurately reflect commercial market rates for first-class borrowers, the requirement in BCB Resolution 2799 that PROEX III support must not result in net interest rates below the CIRR does not mean that PROEX-supported interest rates are no more favourable than those which particular purchasers of Brazilian aircraft could have obtained in the commercial marketplace. We therefore find that the prescription of a CIRR floor for financing operations involving regional aircraft does not establish the absence of a benefit for the buyers of such aircraft.

5.37 We recognise the theoretical possibility that a *particular* purchaser of Brazilian regional aircraft might be able to obtain export credit financing at (or even below[52]) CIRR rates in the commercial marketplace. Even if, as a result, PROEX III did not *always* confer a benefit on the buyer of Brazilian regional aircraft, it is important to bear in mind that this Panel's task is to review the PROEX III programme as such (insofar as it relates to exports of regional aircraft), not just specific situations which may arise under it. We are concerned, in this case, with *all* situations in which PROEX III may reasonably be expected to be involved. Thus, to the extent that PROEX III required Brazil, in *some* situations, to make PROEX III payments that *would* result in a benefit being conferred in respect of regional aircraft, the PROEX III programme would be mandatory legislation (in respect of the conferral of a benefit)[53] and thus a subsidy potentially inconsistent with the *SCM Agreement*.[54]

*(iii) International Market Benchmark*

5.38 Next we must turn to Brazil's argument that it cannot, as a matter of law, use PROEX III in such a way as to confer a benefit on the buyers of Brazilian regional aircraft.[55] Specifically, Brazil refers to Article 8, paragraph 2 of BCB Resolution 2799, which reads as follows:

> In the process of analyzing received requests for eligibility, the [Export Credit Committee] shall have as reference the financing terms practiced in the international market.

5.39 We have addressed a series of questions to Brazil regarding the meaning of Article 8, paragraph 2. In response, Brazil has stated, *inter alia*, that Article 8, paragraph 2 imposes an affirmative requirement on the Export Credit Committee to ensure consistency with the terms practised in the international market; that the relevant "international market" is the market for the product for which PROEX III support is requested; that the relevant financing "practices" are those which do not include official financing support; and that the benchmark "financing terms" are those which would be available to the buyer in question for a comparable transaction in the commercial marketplace.[56] These statements are, in principle, consistent with Brazil's contention that Article 8, paragraph 2 sets forth a mandatory "benefit to recipient" test within the meaning of Article 1.1 of the *SCM Agreement.*

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has stated that at least one of these airlines, Continental Airlines, has actually purchased Embraer regional jets. See Brazil's Comments on Canada's Response to Panel Question 18 (Annex B-6). Continental Airlines was rated, on the date indicated, at "Ba2/BB-".

[52] We believe it may be inferred from the Appellate Body's statement that the CIRR "does not always necessarily reflect the actual state of the credit markets" that it is possible, in principle, for *commercial* interest rates to fall below the CIRR, at least temporarily. See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 64.

[53] The issue of whether PROEX III *requires* Brazil to confer a benefit in respect of regional aircraft is discussed in Section D.2(b)(iv) *infra*.

[54] Of course, a subsidy is not prohibited by the *SCM Agreement*, unless it falls within the scope of Article 3 of the *SCM Agreement*, and unless defences such as the second paragraph of item (k) (discussed in Section E *infra*) are unavailable.

[55] See Brazil's First Submission, para. 15 (Annex B-1); Brazil's Oral Statement, paras. 20 and 23 (Annex B-3).

[56] See Brazil's Responses to Panel Questions 14(a), 14(c), 14(d) and 14(e) (Annex B-5).

5.40 However, Brazil has also noted that "there may be situations in which the CIRR is *below* the marketplace rates [...]. In those circumstances, the Committee could provide PROEX support [in accordance with the provisions of the second paragraph of item (k)]."[57] We understand this statement to mean that Article 8, paragraph 2 would *not* preclude Brazil from granting PROEX III support to reduce net interest rates *below* those which could be obtained commercially.[58] This reply squarely contradicts some of the aforementioned statements by Brazil.

5.41 Since we have no grounds for believing that Brazil's latter statement was made inadvertently[59] and since we see no possibility of resolving the inconsistencies in Brazil's statements other than in favour of Brazil's latter statement[60], we are not persuaded by Brazil's argument that Article 8, paragraph 2 of BCB Resolution 2799 legally *precludes* Brazil from conferring a benefit to the buyers of Brazilian regional aircraft.

*(iv) Mandatory versus Discretionary Conferral of a Benefit*

5.42 To recapitulate, we have found, thus far, that PROEX III payments may, *in the absence of some limitations placed by Brazil on the degree of concessionality of export credits supported by interest rate equalisation*, be expected to allow purchasers of Brazilian regional aircraft to obtain export credits on terms more favourable than those available to them in the commercial market. We have further found that neither of the limitations identified by Brazil -- the minimum interest rate of the CIRR provided for in Article 1, paragraph 1 of BCB Resolution 2799, and the "international market" benchmark established by Article 8, paragraph 2 of that Resolution -- *precludes* Brazil from conferring a benefit through PROEX III interest rate equalisation. The issue which arises, then, is whether our findings up to this point are sufficient for us to conclude that the PROEX III programme, as such, is inconsistent with Article 3.1(a) of the *SCM Agreement.*

5.43 As previously discussed, we are dealing, in this case, with a claim in respect of the PROEX III programme *per se*. Thus, we apply the distinction between mandatory and discretionary legislation. Specifically, the question we must answer is whether PROEX III *requires* the executive branch of the Government of Brazil to act inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement*, and in particular whether PROEX III requires the executive branch to confer a benefit on buyers of Brazilian regional aircraft. In our view, a conclusion that PROEX III *could* be applied in a manner which confers a benefit, or even that it was intended to be and *most likely would* be applied in such a manner, would not be a sufficient basis to conclude that PROEX III as such is mandatory legislation susceptible of inconsistency with Article 3.1(a) of the *SCM Agreement.*

5.44 In considering this issue, we note that BCB Resolution 2799 contains a number of elements which indicate a degree of discretion with respect to the implementation of PROEX III in particular cases. First, we note that Article 1 of BCB Resolution 2799 states in relevant part that:

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[57] Brazil's Response to Panel Question 14(e) (footnote omitted) (AnnexB-5). Brazil made a similar assertion in its Closing Statement to the Panel: "In sum, the Committee, operating under PROEX III will *either* operate under the safe haven of the second paragraph of item (k) *or,* when providing terms of interest rates [*sic*] support consistent with the market under the exception, will confer no 'benefit'." See Brazil's Closing Statement, para. 11 (Annex B-4).

[58] See also Canada's Comments on Brazil's Response to Panel Question 14, para. 7 (Annex A-5).

[59] Brazil specifically reiterated the relevant statement in its response to Panel Question 14(g) (Annex B-5).

[60] We note that nothing on the face of the phrase "the financing terms practiced in the international market" suggests that the benchmark terms must necessarily be the *commercial* terms available to the buyer in question for a comparable transaction. See also Canada's Comments on Brazil's Response to Panel Question 14, para. 4 (AnnexA-5).

> … the National Treasury *may* provide to the financing or re-financing agency […] equalization enough to render financing costs compatible with those practiced in the international market. (emphasis added)[61]

5.45 Brazil considers that, pursuant to this provision, the Export Credit Committee retains discretion regarding whether or not a request for PROEX III support is approved even when all the eligibility criteria are met.[62] On its face, this would appear to be a reasonable interpretation of the text of Article 1. It follows that the Committee would be in a position to deny PROEX III interest rate equalisation in cases where the underlying export credit would, as a result of PROEX III support, be on terms that the borrower could not otherwise obtain in the commercial market.

5.46 We note a further element of the text of BCB Resolution 2799 which would appear to give the Export Credit Committee flexibility to modulate the amount of PROEX III interest rate equalisation depending on the terms of the underlying export credits. Article 1, paragraph 1 of the Resolution provides that:

5.49 We note that Canada itself has asserted that Brazil's executive branch has broad discretionary authority with respect to the administration of PROEX III.[65] Further, Canada has recognised that, under the traditional distinction between mandatory and discretionary legislation, it is incumbent on the complaining party to establish that the executive branch of the responding party is required to act inconsistently with its obligations under the WTO Agreement.[66]

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apply only to export financing operations.[71] Again, Brazil does not dispute that PROEX III payments are export-contingent.

### 3. Conclusion

5.55 On the basis of all the foregoing considerations, we find that PROEX interest rate equalisation payments are financial contributions within the meaning of Article 1.1 and that they are contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement.* However, we further find that Brazil maintains the discretion to limit the provision of PROEX III interest rate equalisation payments to circumstances where a benefit is not conferred in respect of regional aircraft. Accordingly, we conclude that Brazil is not *required* by the PROEX III scheme to provide, in respect of the export of regional aircraft, a subsidy within the meaning of Article 1.1 of the *SCM Agreement* which is contingent upon exportation in the sense of Article 3.1(a).

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(b) "Relevant International Undertaking on Official Export Credits"

5.67 **Brazil** recalls that the second paragraph refers not only to the *OECD Arrangement*

flexibility to update agreements and, therefore, included the possibility of an updated *OECD Arrangement* in the language "a successor undertaking".

5.72 The task facing the **Panel** is to determine the relevant "international undertaking on official export credits". It is well to begin that task by setting out the relevant part of the text of the second paragraph of item (k). It reads:

> … if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members) …

5.73 It is not in dispute that the phrase "an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979" is a

*Arrangement* was in existence at the time the *SCM Agreement* was negotiated. Had Members intended the 1992 *OECD Arrangement* to be the relevant successor undertaking, they could simply have expressed that intention in the text of the second paragraph of item (k). It is significant, in our view, that they did not do so and instead chose to refer, broadly, to "a successor undertaking".

5.83 In view of the foregoing, we conclude that the "successor undertaking" at issue in the second paragraph of item (k) is the most recent successor undertaking which has been adopted prior to the time that the second paragraph is considered. For purposes of these proceedings, we conclude that the most recent successor undertaking which has been adopted is the 1998 *OECD Arrangement*.[81]

5.84 In reaching our conclusion, we have carefully considered Brazil's assertion that to interpret the phrase "a successor undertaking which has been adopted" to refer, at the present time, to the 1998 *OECD Arrangement* leads to a result which is manifestly absurd and unreasonable. Specifically, while Brazil acknowledges that the safe haven in the second paragraph of item (k) is available both to Participants and non-Participants to the *OECD Arrangement*, it argues that this means accepting that a sub-group of Members -- the Participants to the *OECD Arrangement* -- could modify the scope of the second paragraph of item (k), and thus the exception it sets forth, by modifying the relevant provisions of the *OECD Arrangement*. In fact, Brazil contends, they would have *carte blanche* to "perpetually legislate on behalf of the overwhelming majority of the membership". But not only that -- they could legislate in such a way as to accommodate their own preferences at the cost of the rest of the Members. Brazil submits that the Panel must avoid interpreting the second paragraph of item (k) to allow such a result.

5.85 We do not agree that the interpretation of the second paragraph of item (k) which we found to be the correct one and which is based on Article 31 of the Vienna Convention on the Law of Treaties "leads to a result which is manifestly absurd or unreasonable" within the meaning of Article 32 of the Vienna Convention.[82]

5.86 It is true that, under our interpretation, the Participants to the *OECD Arrangement* could modify the 1998 *OECD Arrangement*, and thus effectively the scope of the safe haven in the second paragraph of item (k), without Members' consent.[83] As the Article 21.5 Panel in *Canada – Aircraft* (hereafter "the Article 21.5 Panel") has remarked:

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[81] It should be reiterated here that the 1992 *OECD Arrangement* is no longer in effect.

[82] Article 31(1) of the Vienna Convention reads:

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

> Article 32 of the Vienna Convention reads:

> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
>
> (a) Leaves the meaning ambiguous or obscure; or
> (b) Leads to a result which is manifestly absurd or unreasonable.

[83] We are unable, however, to agree with the view of Brazil that this would amount to an impermissible circumvention of the regular process for amending WTO provisions. Members themselves have agreed to the provisions of the second paragraph of item (k) and to granting to the Participants to the *OECD Arrangement*, *de facto*, the power of modifying the scope of the safe haven. There can thus be no question of "circumvention" of the amendment provisions set forth in the WTO Agreement. Brazil further argues that our interpretation would have serious constitutional implications for Members such as Brazil that incorporate WTO rules into their

5.91 As noted by Canada, the 1979 GATT Subsidies Code contained a provision the wording of which was almost exactly identical to that of the second paragraph of item (k) as it appears in the *SCM Agreement*. Specifically, the 1979 GATT Subsidies Code also used as benchmarks the *OECD Arrangement* as in effect in 1979 or a "successor undertaking which has been adopted by those original signatories". Applying Brazil's interpretation of the *SCM Agreement* to the 1979 GATT Subsidies Code, the relevant "successor undertaking" for purposes of the 1979 GATT Subsidies Code would need to be one that "ha[d] been adopted" in 1979 or on 1 January 1980, when the GATT Subsidies Code came into force. However, neither in 1979 nor on 1 January 1980 was there a "successor undertaking". This confirms our view that the present perfect "has been adopted" cannot be read to refer to the drafters' present, i.e. 1 January 1980.[87]

(c) "Conformity with the Interest Rates Provisions of the Relevant Undertaking"

5.92 **Brazil** considers that the term "interest rates provisions" in the second paragraph of item (k) should be interpreted narrowly because that term, in and of itself, calls for a narrow interpretation. Brazil recalls, in this regard, that the second paragraph narrowly refers to the "interest rates provisions" of the *OECD Arrangement*, and not to the provisions governing the terms and conditions of export credits. On those grounds, Brazil disagrees with the Article

5.96 The Article 21.5 Panel began its inquiry into what were the "interest rates provisions" of the *OECD Arrangement* by noting that, unlike the second paragraph of item (k), the *OECD Arrangement* did not use or define the term "interest rates provisions".[88] It was therefore incumbent on that Panel to construe the term "interest rates provisions". It found that the "interest rates provisions" of the *OECD Arrangement* were those provisions which "specifically" or "directly or explicitly" address interest rates "as such".[89] With that interpretation in mind, the Article 21.5 Panel turned to the *OECD Arrangement* to identify those provisions which were consistent with its interpretation of the term "interest rates provisions". It indicated that it would base its conclusions on a reading of the *OECD Arrangement* which was in accordance with the customary rules of interpretation of public international law and which, in particular, was consistent with the ordinary meaning of the text of the *OECD Arrangement*

provisions. To accept that view would, in our opinion, be to disregard, even to render nugatory, the explicit textual reference to "interest rates" provisions. This we do not feel entitled to do.[97]

5.101 We further note that, if an expansive reading of the term "interest rates provisions" were adopted, then export credit practices with respect to which the 1998 *OECD Arrangement* establishes *no* minimum interest rates -- and with respect to which the *Arrangement* establishes *no* disciplines regarding interest rates -- would nevertheless be "in conformity with the interest rates provisions" of the 1998 *OECD Arrangement*. In our view, it is not possible to read the second paragraph of item (k) in such a manner that export credit practices which are not subject to the minimum interest rates set forth in the 1998 *OECD Arrangement* are nevertheless in conformity with the interest rates provisions of the *Arrangement*.[98]

5.102 In this respect, we agree with the Article 21.5 Panel that the only export credit practices which are subject to the interest rates provisions of the 1998 *OECD Arrangement* at present and which, therefore, are potentially "in conformity" with those provisions are those which are (i) in the form of "official financing support", i.e. direct credits/financing, refinancing or interest rate support, (ii) have repayment terms of at least two years and (iii) have fixed interest rates.[99] It is only in respect of these categories of export credit practices that any minimum interest rates apply.

5.103 While tment

support.[101] The Article 21.5 Panel submitted that any financing transaction consisted of a package of financing terms and conditions, many of which affect the interest rate. Among these were the maximum repayment term, the amount of the cash down payment and the timing of principal and interest payments. The Article 21.5 Panel concluded on that basis that, if minimum interest rates were

haven clause. The Article 21.5 Panel noted that the *OECD Arrangement*, by its terms, drew a distinction between "permitted exceptions" and "derogations".[109] It found that permitted exceptions were "in conformity" with the rules of the *OECD Arrangement*, inasmuch as they involved a departure from relevant provisions of the *OECD Arrangement* in a way which was specifically foreseen and permitted.[110] The Article 21.5 Panel thus concluded that, where official financing support was provided under a permitted exception, the underlying transaction would nevertheless be "in conformity" with the interest rates provisions of the *OECD Arrangement* and thus could qualify for the safe haven in the second paragraph of item (k).[111]

5.108 With respect to derogations, on the other hand, the Article 21.5 Panel considered that they were *not* "in conformity" with the rules of the *OECD Arrangement*, inasmuch as they involved a departure from relevant provisions of the *OECD Arrangement* in a way which was not foreseen and not permitted.[112] Accordingly, where official financing support "derogated" from one of the provisions which could affect the minimum interest rates provision, the underlying transaction would *not* be "in conformity" with the interest rates provisions of the *OECD Arrangement* and thus could *not* qualify for the safe haven in the second paragraph of item (k).[113]

5.109 The Article 21.5 Panel also addressed the so-called "matching" provisions of the *OECD Arrangement* which permit the Participants to the *OECD Arrangement*, within certain limits, to "match" the terms and conditions offered by other Participants and by non-Participants. On this issue, the Article 21.5 Panel took the view that matched permitted exceptions "conformed" with the provisions of the *OECD Arrangement* and, hence, also "conformed" with the interest rates provisions in the sense of the safe haven clause.[114] In contrast, matched derogations were not "in conformity" with the provisions of the *OECD Arrangement* and, as a result, were also not "in conformity" with the interest rates provisions in the sense of the safe haven clause.[115] The Article 21.5 Panel stated, in this regard, that, if it were accepted that matched derogations were "in conformity" with the interest rates provisions of the *OECD Arrangement*, then the concept of "conformity" could not possibly discipline official financing support.[116] The Article 21.5 Panel also recalled that non-Participants to the *OECD Arrangement* would not, as a matter of right, have access to information regarding the terms and conditions offered or matched by Participants. Such information was available only to Participants. Thus, if matched derogations were eligible for the safe haven in the second paragraph of item (k), non-Participants would be at a systematic disadvantage *vis-à-vis* Participants.[117]

5.110 Brazil argues that the approach taken by the Article 21.5 Panel is too broad and that the safe haven clause only requires conformity with the interest rates provisions of the *OECD Arrangement*, as identified by the Article 21.5 Panel. We disagree. The Article 21.5 Panel was correct, in our view, in its underlying assumption that the *OECD Arrangement* provides for minimum interest rates in order to discipline official financing support and that it was on the same grounds that the minimum interest rates provision was incorporated into the safe haven clause. We also agree that minimum interest

[109] *Ibid*., paras. 5.121 and 5.126.

[110] *Ibid*., paras. 5.121 and 5.124. The Article 21.5 Panel referred to Articles 27b), 48 and 49 of the *OECD Arrangement*. *Ibid*., para. 5.123.

[111] *Ibid*., para. 5.126.

[112] *Ibid*., paras. 5.121 and 5.125. The Article 21.5 Panel referred to Articles 28, 29 and 47b) of the *OECD Arrangement*. *Ibid*., para. 5.125.

[113] *Ibid*., para. 5.126.

[114] *Ibid*., paras. 5.124 and 5.126. The Article 21.5 Panel referred to Articles 29 and 51 of the *OECD Arrangement* as well as Articles 25, 29d) and 31 of the Sector Understanding on civil aircraft. *Ibid*., para. 5.124 and footnote 113.

[115] *Ibid*., paras. 5.125 and 5.126. The Article 21.5 Panel referred to Articles 29 and 47b) of the *OECD Arrangement* as well as Articles 25, 29d) and 31 of the Sector Understanding on civil aircraft. *Ibid*., para. 5.125 and footnote 113.

[116] *Ibid*., paras. 5.120 and 5.125.

[117] *Ibid*., para. 5.134.

rates, on their own, could not meaningfully exercise a limiting effect. As we see it, the minimum interest rates were fixed, at a particular level, in the light of and with regard for the fixing of other relevant parameters, i.e. credit terms and conditions. The intended limiting effect of the minimum interest rates cannot, therefore, be achieved unless the relevant parameters are fully respected. Consequently, the Article 21.5 Panel was justified, in our view, in adopting a reading of the concept of "conformity with the interest rates provisions" which safeguards the intended limiting effect of the minimum interest rates provision of the *OECD Arrangement* by requiring adherence also to those terms and conditions of the *OECD Arrangement* which support or reinforce the minimum interest rates provision. We therefore conclude that eligibility of an individual financing transaction for the safe haven in the second paragraph of item (k) cannot be judged on the basis of conformity with minimum interest rates alone.

5.111 As concerns the list of provisions of the *OECD Arrangement* identified by the Article 21.5 Panel as reinforcing the minimum interest rates, we note that that list has not prompted specific

transactions involving matching of derogations were not eligible for the safe haven in the second paragraph of item (k). We find the reasoning of the Article 21.5 Panel in this regard persuasive. There is nothing in the arguments advanced by the two third parties which would give us grounds for deviating from the findings of the Article 21.5 Panel.

5.114 It seems to us that both third parties tend to argue -- incorrectly -- from the standpoint of the *OECD Arrangement* rather than from the standpoint of the safe haven clause and the *SCM Agreement*. The United States considers that it would be unfortunate if Participants to the *OECD Arrangement* were dissuaded from using its matching provisions for fear that doing so might be contrary to the provisions of the *SCM Agreement*. The United States appears to suggest that, deprived of the possibility of matching, Participants would somehow be left defenceless in the face of non-conforming practices under the *OECD Arrangement*. This is not the case, however. It notably

5.117 Finally, we note the European Communities' view that the fact that non-Participants do not receive the notifications of non-conforming terms which Participants receive should not stop them from matching non-conforming offers. According to the European Communities, non-Participants could simply proceed to match if they did not receive adequate information from the party which they suspect of offering non-conforming terms.[127] Even were we to accept this point, non-Participants would still be at a systematic disadvantage compared to Participants in all those situations where Participants notify other Participants, on their own motion, of non-conforming terms, as required by the *OECD Arrangement*.[128] The European Communities' point fails to dispose of *this* argument.

5.118 In conclusion, having carefully considered the reasoning of the Article 21.5 Panel and the arguments presented by the parties and third parties to these proceedings, we adopt the interpretation adopted by the Article 21.5 Panel of the phrase "in conformity with [the interest rates provisions of the *OECD Arrangement*]".

**3.**

compliance with the interest rates provisions of the *OECD Arrangement*, PROEX III should, under the traditional mandatory vs. discretionary distinction, be considered to be in conformity with Brazil's WTO obligations until Canada proves otherwise.

5.123 The **Panel** considers that the distinction between mandatory and discretionary legislation is applicable in the context of the second paragraph of item (k). It is of course correct that, in the present context, we are concerned not with conformity with a WTO *obligation*, but with conformity with conditions attached to a WTO *exception.* This fact alone does not, however, render the GATT/WTO distinction between mandatory and discretionary legislation inapplicable or inappropriate.[130]

5.124 In our understanding, the rationale underpinning the traditional GATT/WTO distinction between mandatory and discretionary legislation is that, when the executive branch of a Member is not required to act inconsistently with requirements of WTO law, it should be entitled to a presumption of good faith compliance with those requirements. We consider that that rationale is no less valid in the context of WTO exceptions than it is in the context of WTO obligations. Indeed, were we to take the opposite view, we would, in effect, create a situation where Members would be entitled to a presumption of good faith compliance with their WTO *obligations*, but not with the conditions attached to WTO *exceptions*. Such a situation would, in our view, be unwarranted and contrary to logic.[131]

5.125 We have stated above that the Member invoking an exception as an affirmative defence has the burden of establishing it. In our view, the allocation of the burden of proof is a procedural issue[132] which is distinct from the substantive standard to be applied in assessing the conformity of legislation with a particular provision of the *WTO Agreement*. Simply put, the allocation of the burden of proof determines *who* must show something. On the other hand, the GATT/WTO distinction between mandatory and discretionary legislation determines *what* somebody must show. We believe the standard to be applied in judging the conformity of a piece of legislation with WTO requirements should be the same irrespective of who has the burden of adducing argument and evidence sufficient to establish a *prima facie* case of conformity.

5.126 Accordingly, the task before us is to examine whether, under PROEX III, Brazil is *required* to act in a manner that is *not* in conformity with the interest rates provisions of the 1998 *OECD*

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[130] We are aware that the Article 21.5 Panel in *Canada – Aircraft* employed a different substantive standard in determining whether certain Canadian measures qualified for the safe haven of the second paragraph of item (k). Specifically, its inquiry focused on whether certain policy guidelines were sufficient to "ensure" the conformity of the future application of a Canadian subsidy programme with the second paragraph of item (k). See Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, para. 5.141. Three observations should be made in this respect. *First*, the Article 21.5 Panel adopted the "ensure" standard on the basis that Brazil and Canada effectively agreed that this should be the applicable standard. In the present proceedings, the parties do not agree that this Panel should apply the "ensure" standard. *Second*, the Appellate Body, in reviewing the report of the Article 21.5 Panel, expressed some discomfort with the possible implications of applying a strict "ensure" standard. The Appellate Body considered that no Member could provide "a strict guarantee or absolute assurance as to the *future* application of [a measure] [...] since no one can predict how unknown administrators would apply, in the unknowable future, even the most conscientiously crafted compliance measure". See Article 21.5 Appellate Body Report on *Canada – Aircraft*, *supra*, para. 38. *Third*, we recall that the Article 21.5 Panel in *Canada – Aircraft* was reviewing a subsidy programme *as applied*, and not a subsidy programme as such. In the light of the foregoing, we think it would not be appropriate, in this case involving a challenge to the PROEX III programme *per se*, to require Brazil to demonstrate that it is "ensuring" that all future PROEX III payments in respect of regional aircraft will satisfy the requirements of the second paragraph of item (k).

[131] It should be pointed out that the various exceptions provided for in the *WTO Agreement* are an integral and important part of the carefully negotiated balance of rights and obligations of Members.

[132] We note the Appellate Body's view that "... the burden of proof is a procedural concept which speaks to the fair and orderly management and disposition of a dispute." (Original Appellate Body Report on *Canada –Aircraft*, *supra*, para. 198)

interest rate support. The **United States** notes that "interest rate support" refers to practices under which a government enters into an agreement on interest rates with a commercial bank that is providing the export credit financing for an export credit transaction, but is not sufficiently familiar with the facts to opine as to whether PROEX III payments, as applied, constitute interest rate support.

5.131 The **Panel** notes that the 1998 *OECD Arrangement* does not define the term "interest rate support". It merely states that "interest rate support" is a form of official financing support.[136] Since the 1998 *OECD Arrangement* does not give a special meaning to the term "interest rate support", we must read it in accordance with its ordinary meaning in context.

5.132 We consider that, in its ordinary meaning, the term "interest rate support" relates broadly to official support for one particular export credit term, namely the interest rate to be paid in connection with export credits. Moreover, as a matter of relevant context, it is clear from the 1998 *OECD Arrangement* that interest rate support is distinct from direct credits/financing, refinancing, export credit insurance and guarantees.[137] From this it may be deduced that official interest rate support will normally involve government payments to providers of export credits.[138] For such payments to amount to "support", we think they need to be made with the aim or effect of securing net borrowing rates for the recipients of export credits which are lower than they would have been in the absence of official financing support.[139]

5.133 Turning to PROEX III, we note that BCB Resolution 2799 envisages payments by the Government of Brazil to financial institutions "enough to render financing costs [i.e. net interest rates] compatible with those practiced in the international market."[140] Thus, PROEX III provides for support for interest rates ("financing costs"), involves payments by the Brazilian Government to commercial providers of export credits and is designed to lower the net interest rates charged by particular commercial lenders to levels which are compatible with those prevailing in the international market. In light of this, we conclude that PROEX III support constitutes "interest rate support" as we understand that term.[141]

5.134 The above considerations also lead us to conclude that PROEX III is an export credit practice subject to the interest rates provisions of the 1998 *OECD Arrangement.* Accordingly, PROEX III is *potentially* in conformity with the interest rates provisions of the *OECD Arrangement.*

(c) Conformity with the Interest Rates Provisions of the 1998 *OECD Arrangement*

5.135 The safe haven of the second paragraph of item (k) is available, by its terms, to Participants to the relevant undertaking on official export credits, i.e. the *OECD Arrangement*, as well as to those

[136] See the Introduction to the 1998 *OECD Arrangement*. In fact, notes to the 1992 *OECD Arrangement* indicate that "it has not proved possible to establish common definitions of interest rate and official support in light of differences between long-established national systems …" See Article 24(m) 1992 *OECD Arrangement*. We see no indication in the text of the 1998 *OECD Arrangement* that these differences of view among Participants have been resolved.

[137] See the Introduction and Articles 2 and 15 of the 1998 *OECD Arrangement*.

[138] See Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.53 and footnote 53.

[139] Canada argues that PROEX III payments are "significantly different from the interest rate support practices of the Participants" (Canada's Response to Panel Question 17; Annex A-4). Our task, however, is not to determine whether PROEX III is like practices of the Participants to the 1998 *OECD Arrangement*, but whether it involves interest rate support within the meaning of the *Arrangement*. As for Canada's argument that, whether or not PROEX III payments are interest rate support, they are not in conformity with the interest rates provisions of the 1998 *OECD Arrangement*, we will address this in the context of our examination of whether PROEX III allows Brazil to provide payments in conformity with those provisions.

[140] Article 1 of BCB Resolution 2799. See also Article 1, paragraph 1 of the same Resolution, which specifically relates to interest rate equalisation for export financing operations involving regional aircraft.

[141] None of the Participants in these proceedings has specifically contested that PROEX III is properly viewed as one form of "interest rate support".

5.141 Canada disagrees with the last point, arguing that the wording of Article 1, paragraph 1 would not prevent Brazil from supporting net interest rates at below-CIRR level. The Portuguese version of BCB Resolution 2799 uses the words "respeitada a … CIRR", which Brazil translates as "complying with". We are satisfied that this is an accurate translation and also that this language requires Brazil to "respect" or "comply with" the relevant CIRR.[149]

5.142 In any event, we recall that we are examining the consistency of the PROEX III scheme *as such* and that the question before us is, therefore, whether PROEX III *allows* compliance with the interest rates provisions of the 1998 *OECD Arrangement*. Even if Canada were correct that BCB Resolution 2799 did not *require* that net interest rates supported by PROEX III be at or above the CIRR, it certainly *envisions* that they will be. Thus, we cannot say that PROEX III does not *allow* compliance with Article 22 of Annex III.

<u>Article 16 (on the construction of CIRRs) and Article 17 (on the application of CIRRs)</u>

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5.147 In reviewing PROEX III for conformity with Article 17a), it must be borne in mind that, once the Export Credit Committee has approved a request for PROEX III support, a letter of commitment is issued to the applicant.[151] As we explained in our previous Article 21.5 report, such a letter

> […] commits the Government of Brazil to providing support as specified for the transaction provided that the contract is entered into according to the terms and conditions contained in the request for approval, and provided that it is entered into

5.153 The **Panel** agrees with Canada that Articles 18 and 19 apply to official financing support in

under Article 8, paragraph 2 of BCB Resolution 2799. Brazil argues that, in accordance with the provisions of that Article, the Committee could -- but would not be required to -- approve interest rate support in excess of 85 per cent of the export contract value only if this were consistent with the terms prevailing in the international market.

5.160 We note that it is legally possible for Brazil to approve interest rate support exceeding the 85 per cent limit, but that Brazil is not obliged to do so. Thus, by necessary implication, PROEX III *allows* Brazil to comply with Article 7. In fact, the Export Credit Committee is *required* to adhere to the maximum percentage set forth in Article 5 of Directive 374 unless it affirmatively decides to use the discretion conferred on it under Article 8, paragraph 2 of BCB Resolution 2799. [160]

5.161 This finding is unaffected by Canada's argument that Article 5 of Directive 374 existed already prior to PROEX III. Even if Article 5 did not, as Canada alleges, impose any disciplines in respect on PROEX II, we see no justification for assuming, on the basis of an alleged past practice, that Brazil will, much less that it is *required* to apply PROEX [illegible] 0.3513 Tw

PROEX III is used to buy down risk premiums, Brazil would not be providing interest rate support as envisaged in Article 14.

5.166 The **Panel** recalls that Article 13 of the 1998 *OECD Arrangement* requires that the principal sum of an export credit must normally be repaid in equal and regular instalments not less frequently than every six months, with the first instalment to be made no later than six months after the starting point of credit. Article 14 of the 1998 *OECD Arrangement* stipulates that interest must not normally be capitalised during the repayment period, but must be paid not less frequently than every six months, with the first payment to be made no later than six months after the starting point of credit.

5.167 We recall that we have agreed with the Article 21.5 Panel in *Canada – Aircraft* that, where official financing support was provided under a permitted exception, the underlying transaction would nevertheless be in conformity with the interest rates provisions of the 1998 *OECD Arrangement*.[162] We note that Articles 13a) and 14a) provide that principal and interest "shall normally" be treated in a particular fashion. We further note that Article 49 of the 1998 *OECD Arrangement*, entitled "Permitted Exceptions: Prior Notification Without Discussion" includes notification of a Participant's intention "not to follow normal payment practices with respect to the principal or interest referred to in Articles 13 a), b) and 14 a)".[163] Thus, we conclude that Brazil may be in conformity with the interest rates provisions of the 1998 *OECD Arrangement* even if it does not respect these provisions.[164]

5.168 We agree with Canada that one element of Article 13a), the requirement that the first instalment of principal be made within six months after the starting point of credit, is subject to a non-derogation engagement under Article 27 of the 1998 *OECD Arrangement*. It thus is not a permitted exception. Canada alleges that Article 2 of Directive 374 enables Brazil to approve transactions which do not comply with this element of Article 13a).[165] Canada does not, however, contend that Brazil is *required* to approve transactions that do not comply. Further, Canada does not address Article 3 of BCB Resolution 2799, referred to by Brazil[166], which specifically requires that the principal of the underlying commercial export credit be repaid in six-monthly instalments and that the first instalment be made six months after one of certain specified events.[167] In the absence of a response from Canada, we see no reason to reject Brazil's assertion that Article 3 of BCB Resolution 2799 may be applied consistently with Article 13a).

Articles 20–24 (on minimum premium benchmarks)

5.169 **Brazil** considers that the provisions of the 1998 *OECD Arrangement* on minimum premiums do not apply to interest rate support and are, therefore, not relevant to PROEX III. Brazil notes that

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[162] See Section E.2(c) *supra*.

the language of Article 20 expressly omits interest rate support from the application of the minimum premiums. Brazil also points out that PROEX III does not provide protection to the lender for possible default by the borrower. Brazil considers that there is, therefore, no need for charging a premium.

5.170 **Canada** agrees that interest rate support is not covered by Article 20 because its provision does not remove the risk of non-repayment by the borrower for the lending institution. Canada also acknowledges that this risk can only be assumed when a government provides interest rate support in association with a guarantee or insurance in respect of the credit risk.

5.171 The **Panel** notes that Article 20 requires the Participants to the 1998 *OECD Arrangement* to charge the appropriate minimum premium rate when providing official support through direct credits/financing, refinancing, export credit insurance and guarantees. Article 20 conspicuously fails to include interest rate support in the categories of official support for which a minimum premium is to be charged. This raises the issue of whether this omission should be given meaning. No party or third party to these proceedings suggests that, under the 1998 *OECD Arrangement*, governments must *necessarily* provide interest rate support in conjunction with credit risk insurance or guarantees. This being so, it is not apparent why governments should be required to charge a premium when they do not assume an obligation to compensate exporters or financial institutions in the case of default by borrowers.[168] In the light of this, we consider it implausible that the concept of interest rate support was omitted in Article 20 by inadvertence. We therefore conclude that interest rate support is not covered by the provisions of Article 20 or the other provisions dealing with the issue of minimum premiums, i.e. Articles 21-24.[169]

5.172 Since we have found that PROEX III support constitutes interest rate support and since it has not been suggested that PROEX III requires the Government of Brazil to provide interest rate support in association with credit risk insurance or guarantees, we conclude that PROEX III is not subject to the provisions of Articles 20-24.[170]

Article 25 (on local costs) and Article 26 (on maximum validity periods for export credit terms)

5.173 **Brazil** notes with respect to Article 25 that PROEX III does not provide for the financing of local costs. As concerns Article 26, Brazil considers that the maximum validity periods for lines of credits do not apply to interest rate support such as PROEX III.

5.174 **Canada** has not addressed the conformity of PROEX III with Articles 25 and 26.

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[168] For the same reason, we do not appreciate the European Communities' assertion that the provision of pure interest support amounts to a circumvention of the minimum premium provisions of the 1998 *OECD Arrangement*. See the European Communities' Response to Panel Question 27 (AnnexC-6).

[169] It is important to note, however, as did the Article 21.5 Panel in *Canada – Aircraft*, that "[…] a transaction that involve[s] interest rate support *and* a guarantee or insurance would need to respect the interest rate provisions of the *Arrangement*, as well as the requirements pertaining to minimum premia […] to be 'in conformity' with the interest rate provisions of the *Arrangement*." (Article 21.5 Panel Report on *Canada – Aircraft*, *supra*, footnote 103; emphasis added.)

[170] The European Communities, in our view, mischaracterizes PROEX III when it asserts that it is the economic equivalent of an insurance or guarantee. See the European Communities' Response to Panel Question 27 (AnnexC-6) and also Canada's Comments on Brazil's Response to Panel Question 11 (Annex A-5). It is true that interest rate support under PROEX III may, in effect, reduce the risk of non-repayment by the borrower inasmuch as lower interest rates make it easier for the borrower to meet its obligation to repay the principal sum and pay interest. However, this kind of risk reduction is not at issue in Articles 20-24, which are not concerned with interest rate support. It is also very different from the kind of risk reduction associated with export credit insurance and guarantees. Unlike in the case of pure interest rate support, credit risk insurance or guarantees require a government to *compensate* the lender in case the borrower *actually* fails to repay the principal sum or pay interest. No such requirement is envisaged under PROEX III.

5.175 The **Panel**

requirement in the second sentence of Article 19 -- that Participants must do everything in their power to prevent an erosion of the customary market terms -- we think that Brazil, by promulgating Article 8, paragraph 2 of BCB Resolution 2799, has "done" enough to bring PROEX III, as such, in conformity with this requirement.

5.181 In view of the foregoing, we conclude that PROEX III, as such, is in conformity with the provisions of Article 19 of Annex III.

Article 21 of Annex III (on maximum repayment terms)

5.182 **Brazil** submits that PROEX III complies fully with the requirements of Article 21 of Annex III, which stipulates that the maximum repayment term for Category A aircraft, such as those of Embraer, is 10 years. Brazil argues that the basis for its assertion that the maximum length of the financing term under PROEX III is 10 years is the specific requirement to that effect in Directive 374 and the requirement of Article

that the maximum financing term for aeroplanes (HS code 8802, except 8802.11 and 8802.20) is 120 months, i.e. 10 years. This, in our view, is fully consistent with Article 21 of Annex III. As an

not think Brazil is obliged, at this point, to establish the conformity of PROEX III with Article 28a) of Annex III.[183]

Article 29a) of Annex III (on spare engines and spare parts ordered with aircraft)

5.198 **Brazil** points out that Article 6 of Directive 374 permits applicants to include spare parts financing in their application for equalisation support and gives the Export Credit Committee the discretion to finance up to 20 per cent of the spare parts included in a transaction. Brazil argues, however, that the Committee is not required to do so and will not do so with respect to regional aircraft because of the insignificant percentage of the value of the spare parts included in regional aircraft export sales. Brazil considers, therefore, that Article 6 conforms to the requirements of Article 29a).

5.199 **Canada** submits that Article 6 of Directive 374 allows for financing of up to 20 per cent for spare parts, whereas Article 29a) limits financing for spare parts to a maximum of 15 per cent of the aircraft price for the first five aircraft and to 10 per cent for the sixth and subsequent aircraft. Canada considers, therefore, that Article 6 explicitly exceeds the limit laid down in Article 29a). Canada also asserts that, in any event, Brazil regularly uses its discretion to waive the limits on PROEX.

5.200 The **Panel** notes the provisions of Article 29a), according to which spare engines and spare parts, when ordered with aircraft, may be financed on the same terms as the aircraft.[184] However, Article 29a) makes this possibility subject to the requirement that account be taken of the size of the fleet of each aircraft type. Accordingly, for the first five aircraft of a particular type in the fleet, financing of spare engines and spare parts may be provided up to an amount equivalent to 15 per cent of the aircraft price. For the sixth and subsequent aircraft of that type in the fleet the financing of spare engines and spare parts must not exceed an amount equivalent to 10 per cent of the aircraft price.

5.201 The parties disagree over whether PROEX III, and in particular Article 6 of Directive 373,ocArticlegsl limit la

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negotiated by the exporter and the buyer. *They* decide whether or not to "include" spare parts in a transaction. Article 6, as we understand it, makes clear that transactions for which PROEX III support is requested may include spare parts and are thus eligible, in principle, for PROEX III support. It is also apparent from Article 6 that if transactions include spare parts worth *in excess of* 20 per cent of the price of the principal good of the transaction, they are *not* eligible for PROEX III support. Thus, we are not convinced that the Committee could, *on the basis of Article 6*, refuse to approve a request for PROEX III support for a transaction which includes spare parts worth *up to* 20 per cent of the price of the principal good in question.

5.204 We recall, however, Brazil's uncontested statement to the effect that the Export Credit Committee has discretion regarding(They) Tj 21 0 ,r3 recall, however, Brazil's ue99a25186 Tw (59II support.

second paragraph of item (k), it would nevertheless not be prohibited because PROEX III payments do not secure a material advantage in the field of export credit terms within the meaning of the first paragraph of item (k). Brazil accepts that, for this defence to succeed, it must establish (i) that the first paragraph of item (k) may be used to establish that PROEX III is not a prohibited export subsidy (possibility of an *a contrario* interpretation of the first paragraph), (ii) that PROEX III payments are payments within the meaning of the first paragraph of item (k) and (iii) that PROEX III payments are not used to secure a material advantage in the field of export credit terms.

5.211 **Canada** rejects Brazil's defence under the first paragraph of item (k). Canada agrees, however, that it is up to Brazil to make a *prima facie* case with respect to each of the three elements referred to by Brazil. Canada also invites the Panel to make detailed findings in respect of all three elements in order to facilitate the effective resolution of the present dispute.

5.212 The **Panel** recalls that the first paragraph of item (k) identifies as an export subsidy:

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

5.213 Brazil submits that PROEX III payments are payments by the Government of Brazil "of the costs incurred by exporters or financial institutions in obtaining credits". Brazil maintains, however, that PROEX III payments are *not* "used to secure a material advantage in the field of export credit terms" and that, therefore, they are not prohibited export subsidies.

5.214 In our view, Brazil's claim presents three issues. *First*, is Brazil correct, as a legal matter, that the first paragraph of item (k) may operate as an affirmative defence? *Second*, are PROEX III payments "payments" within the meaning of the first paragraph of item (k)? *Third*, are PROEX III payments used to secure a material advantage in the field of export credit terms? We agree with the parties that, if Brazil is correct that the first paragraph of item (k) may operate as an affirmative defence, then Brazil would have the burden of proof with respect to the latter two issues. We further note that, if Brazil is unsuccessful with respect to any of the three issues presented, Brazil's alleged affirmative defence must fail.[186]

## 2. Payment of the Costs Incurred in Obtaining Credits

5.215 We first examine whether Brazil has demonstrated that PROEX III payments are payments within the meaning of the first paragraph of item (k).

5.216 **Brazil** contends that PROEX III payments are "payments" within the meaning of the first paragraph of item (k). Brazil further argues that the language "payment of […] the costs incurred by exporters or financial institutions in obtaining credits" contemplates that exporters and financial institutions "obtain" credits. Neither exporters nor financial institutions, however, "obtain" credits simply to hoard them. In Brazil's view, both "provide" to export purchasers the credits they have previously "obtained". Brazil considers that the first sentence of the first paragraph of item (k) supports this view. That sentence deals with the grant by governments "of export credits at rates below those which they actually have to pay for the funds so employed". Brazil argues that, just as the use of the term "export credits" in the first part of the first paragraph of item (k) justifies anTD /F5 s"vt ra

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> … we note first the use of the word "credits" in the plural. It seems clear in context that the word "credits" refers to "export credits" as used earlier in the paragraph. Second, the costs involved are those relating to *obtaining* export credits, and not costs relating to providing them.
>
> […]
>
> Further, if the drafters had intended to refer to payments related to a financial institution's cost of borrowing, the first part of the first sentence of item (k) demonstrates that they knew how to do so.[187]

5.223 Based on this interpretation, we found that the financial institutions involved in financing PROEX-supported transactions *provided* export credits, but that they could not be seen as *obtaining* export credits. We therefore concluded that PROEX II payments were not "payments" within the meaning of the first paragraph of item (k). That conclusion remains correct also with respect to payments under PROEX III.

5.224 In the present proceedings, however, Brazil submits that our *interpretation* of the "payment" clause was incorrect and that the clause should instead be construed to refer to the "payment of … the costs incurred by exporters or financial institutions in obtaining the [export] credits [they provide to borrowers]".[188] Brazil argues that, thus interpreted, the "payment" clause covers PROEX III payments.

5.225 For purposes of resolving the issue before us, we need not take position on the interpretation of the "payment" clause advocated by Brazil.[189] Even assuming Brazil's interpretation were correct, Brazil has, in our view, failed to demonstrate that PROEX III payments are payments by the Government of Brazil of all or part of the costs incurred by Embraer or financial institutions "in obtaining the export credits they provide".

5.226 Brazil argues that, when the financial institution is outside of Brazil, Embraer, i.e. the *Brazilian exporter*, faces costs in obtaining export credits for its customers. While this may or may not be true, PROEX III payments are made to financial institutions financing exports of revj - a Tw (clause wa

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5.228 In accordance with the foregoing, we conclude that PROEX III payments do not fall within the scope of the "payment" clause of the first paragraph of item (k).

### 3. Material Advantage

5.229 Since we have found that PROEX III payments are not payments within the meaning of the first paragraph of item (k), Brazil has not established its defence under the first paragraph. In the interests of facilitating a full resolution of this dispute, however, we proceed to analyse whether Brazil is correct that PROEX III payments are not "used to secure a material advantage in the field of export credit terms" within the meaning of the first paragraph of item (k).

5.230 To resolve this issue, we must, as an initial matter, identify the appropriate benchmark, in the present case, for determining whether PROEX III is "used to secure a material advantage in the field of export credit terms". Once we have defined the relevant benchmark, we will examine whether PROEX the payments benchmark,
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CIRR can be offered to borrowers *irrespective* of what the other export credit terms and conditions are. We do not think that the Appellate Body would have introduced such a significant distinction *sub silentio*.

5.243 In fact, when considering the implications of the view that, with respect to the first paragraph of item (k), the CIRR, on its own, is an appropriate market benchmark, we have no hesitation in concluding that the Appellate Body could not have adopted that view. On that view, Members could, for instance, support export credits with net interest rates at CIRR level, repayment terms of 100 years, no cash payment requirement and with the principal sum to be repaid at the very end of the credit term. To accept this possibility would, in our view, deprive the material advantage clause of the first paragraph of item (k) of any useful effect.

5.244 By way of a final consideration, we wish to note that the Appellate Body's failure specifically to acknowledge the importance of export credit terms other than the CIRR itself may well have been inspired by the wording of the second paragraph of item (k). Like the Appellate Body's statement, the second paragraph only refers to an "interest rate" benchmark, which, in essence, is the CIRR. Yet, as discussed above, this reference in the second paragraph to the CIRR does not imply that export credit practices benefit from the safe haven even if they do not conform to those provisions of the *OECD Arrangement* which operate to support or reinforce the CIRR.

5.245 In conclusion, and for the reasons set forth above, we find that the Appellate Body did not mean to suggest, at para. 67 of its Article 21.5 report on *Brazil – Aircraft*, that compliance with the CIRR alone would, *ipso facto*, be dispositive of the issue of whether relevant payment support for export credits is used to secure a material advantage in the field of export credit terms.

5.246 Having found that compliance with the CIRR alone is not sufficient to establish that PROEX III does not confer a material advantage, it is necessary to determine, next, what terms and conditions PROEX III would need to respect, in addition to the CIRR, to justify a finding that PROEX III does not secure a material advantage.

5.247 We recall that, in reaching its conclusion that the CIRR was a relevant international benchmark for determining whether payments were used to secure a material advantage in the field of export credit terms, the Appellate Body relied upon the second paragraph of item (k) as relevant context.[194]

5.248 As we have already seen, the second paragraph of item (k) offers a safe haven for export credit practices that are in conformity with the interest rate provisions of the 1998 *OECD Arrangement.* While compliance with the CIRR is a necessary element for establishing such conformity, we have concluded that, on a proper interpretation, "conformity with" the CIRR cannot be said to be achieved, unless the CIRR as well as all (applicable) rules of the *OECD Arrangement* which operate to support or reinforce the CIRR are complied with.

5.249 As a matter of contextual interpretation, we believe that the concept of "conformity with the CIRR" as it exists in the "material advantage" clause[195] should normally have the same meaning as the

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[194] The Appellate Body stated that:

> … the second paragraph of item (k) [constitutes] *useful context* for interpreting the "material advantage" clause in the text of the first paragraph. (Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 181 (emphasis added)).

[195] We realise that the concept of "conformity with the CIRR" does not appear, as such, in the text of the material advantage clause. It is sufficient to note, in this regard, that we must take as given the Appellate Body's interpretation of that clause. See Article 21.5 Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 67 ("To establish that subsidies under the revised PROEX are not 'used to secure a material advantage in the

concept of "conformity with the CIRR" as it exists in the second paragraph of item (k). In our view, there would be little logic to interpreting the first paragraph of item (k) in the light of one element found in the second paragraph of item (k) -- the CIRR -- while neglecting other elements of the second paragraph which are essential to determining whether an export credit practice is in conformity with the CIRR.

5.250 We note that the reasoning which underpins our interpretation of the second paragraph of item (k) applies with equal force to the Appellate Body's interpretation of the "material advantage" clause. In this regard, it is sufficient to recall our view that the CIRR cannot meaningfully perform the limiting function of a minimum commercial interest rate unless it is applied as part of the package of terms and conditions set forth in the *OECD Arrangement*.[196] If that is a correct view, then it must

*(ii) Appropriateness of a Benchmark Other than the CIRR*

5.253 **Canada** recalls that the Appellate Body has stated that the CIRR may not always reflect the rates available in the marketplace. In Canada's view, the Appellate Body has therefore recognized that the role of the CIRR is to serve as a proxy for market rates. It follows that, whenever the CIRR is not an adequate proxy for market rates, a benchmark other than the CIRR *must* be used. Specifically, Canada asserts that the CIRR is not an appropriate benchmark with respect to transactions involving regional aircraft, because the CIRR is usually significantly different from the rates available for comparable market transactions involving regional aircraft. Canada notes that the CIRR is significantly different even from the rates available to the airline with the best credit rating, i.e. American Airlines.

5.254 Canada argues, in addition, that, in assessing whether PROEX III is used to secure a material advantage in the field of export credit terms, account must also be taken of the creditworthiness of the borrower in question. Canada considers that a lender will certainly confer a material advantage if, by offering financing at the CIRR, it is permitted to offer a less credit-worthy borrower the same low interest rate as a more credit-worthy borrower.

5.255 **Brazil** counters that the CIRR, by its design, is intended to reflect market rates and that, in the view of experts, the CIRR may from time to time actually be higher than market rates. In fact, according to Brazil, the CIRR presently is above the market rates. Brazil argues further that, in any event, it follows from the Appellate Body's Article 21.5 report on *Brazil – Aircraft* that Brazil is entitled to establish a benchmark interest rate and that it may use the CIRR as a benchmark in assessing applications for PROEX assistance.

5.256 The **Panel** agrees with the premise of Canada's argument, namely that the Appellate Body considered (i) that the CIRR represents an example of a *market* benchmark and (ii) that the CIRR need not accurately reflect the marketplace *at all times*. That premise, however, does not lead us to the same conclusion as Canada, because we have a different reading of the Appellate Body's Article 21.5 report on *Brazil – Aircraft.* We consider the following passage of that report to be particularly pertinent:

> Where the CIRR does not, in fact, reflect the rates available in the marketplace, we believe that a Member should be *able*, in principle, to rely on evidence from the marketplace itself in order to establish an alternative "market benchmark", on which it might rely in one or more transactions.[200]

5.257 Canada would have us construe this statement as *requiring* that a Member that seeks to demonstrate that its payments are not used to secure a material advantage must, in the circumstances referred to, use a benchmark other than the CIRR. We think that the plain words of the Appellate Body do not support such a conclusion. The Appellate Body did not say that a Member "must" establish an alternative benchmark where the CIRR does not reflect the rates available in the marketplace. Instead, the Appellate Body said that a Member should, "in principle", be "able" to do so, that is, that it should have the possibility to do so.[201]

5.258 There is another statement by the Appellate Body which appears to contradict Canada's interpretation. As will be recalled, the Appellate Body stated that:

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> To establish that subsidies under the revised PROEX are not "used to secure a material advantage in the field of export credit terms", Brazil must prove *either*: that the net interest rates under the revised PROEX are at or above the relevant CIRR, the specific "market benchmark" we identified in the original dispute as an "appropriate" basis for comparison; *or*, that an alternative "market benchmark", other than the CIRR, is appropriate, and that the net interest rates under the revised PROEX are at or above this alternative "market benchmark".[202]

5.259 This statement confirms, in our view, that the Appellate Body did not mean to suggest that Members were under an obligation to use a benchmark other than the CIRR where the CIRR does not correspond to market rates. To the contrary, this statement suggests to us that the Appellate Body meant to leave it up to an individual Member to decide whether to use a CIRR benchmark or, in the alternative, identify and establish the appropriateness of a different benchmark.

5.260 Accordingly, while we see merit in Canada's argument that the CIRR may not constitute an "appropriate" market benchmark in situations where it differs significantly from the rates available to borrowers in comparable market transactions, we nevertheless cannot accept that argument in view of our understanding of the Appellate Body's Article 21.5 report on *Brazil - Aircraft*.[203]

5.261 Canada argues that, in examining whether PROEX III is used to secure a material advantage, regard must also be had to the creditworthiness of the borrower in question. We recall that, in our first Article 21.5 report, we explained that:

> The reasoning of the Appellate Body in choosing the CIRR seems to have been that a payment would be used to secure a *material* advantage … if it resulted in an interest rate that was below the lowest *commercial* interest rates available to the best borrowers in respect of a particular currency, <u>irrespective of whether that rate would have been available to the borrower in question</u>.[204]

5.262 In other words, in our understanding, the Appellate Body identified the CIRR as an "absolute" benchmark, that is to say, as a benchmark that could be used even where the borrower in question could not have obtained a rate at the CIRR level in the commercial market.

5.263 It should be pointed out that the Appellate Body, in its Article 21.5 report, did not contradict our interpretation of its reasoning. Nor do we see, in that report, any other statements which would make us reconsider our statement. Whereas we find Canada's argument persuasive, as a general matter,[205] this does not provide us with a justification for departing from what we consider to be the Appellate Body's view.

5.264 For these reasons, we reject Canada's argument that the creditworthiness of borrowers must be taken into account when assessing whether PROEX III confers a material advantage within the meaning of the first paragraph of item (k).

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[202] Article 21.5 Appellate Body Report, *supra*, para. 67 (emphasis in the original, but footnote omitted).

[203] With respect to the fact that Canada's argument relates specifically to export transactions involving regional aircraft, it is sufficient to note (i) that nothing in the Appellate Body's Article 21.5 report on *Brazil - Aircraft* suggests that the CIRR benchmark does not apply to transactions involving regional aircraft and (ii) that, in fact, the underlying dispute concerned regional aircraft. We must assume, therefore, that the Appellate Body meant to make it possible for Members to use the CIRR as benchmark in transactions involving regional aircraft.

[204] Article 21.5 Panel Report on *Brazil – Aircraft*, *supra*, para. 6.91 (underlining added).

[205] We note that Canada's argument is similar in content to our original finding that the question of whether there was a "material advantage" was comparable to the question of whether there was a benefit to the recipient. See Panel Report on *Brazil – Aircraft*, *supra*, para. 7.23. The Appellate Body, however, overturned our finding on that issue. See Original Appellate Body Report on *Brazil – Aircraft*, *supra*, para. 179.

5.265 For the foregoing reasons, we find that a Member may always use the CIRR -- accompanied by the applicable rules of the *OECD Arrangement* which operate to support or reinforce the CIRR as a minimum interest rate -- as a benchmark to demonstrate that a payment is not used to secure a material advantage in the field of export credit terms.[206] Given the nature of the CIRR as a (periodically) constructed interest rate, a Member may, however, attempt to demonstrate that a rate *below* the CIRR would, at a particular point in time, constitute a more appropriate benchmark.

(b) Examination of PROEX III

5.266 We recall that, to establish that PROEX

redundant and the principle of effective treaty interpretation breached. Nor can Brazil establish, in Canada's view, that a measure impliedly excluded from the list of illustrations in Annex

governed by footnote 5 to the *SCM Agreement*, and that the first paragraph of item (k) does not "refer to" any measures as "not constituting export subsidies" within the meaning of the footnote. We consider that this reading gives effect both to the material advantage clause *and* to footnote 5.[214] As a result, we incorporate by reference our reasoning in the first Article 21.5 panel report into this Section.

### 5. Conclusion

5.276 We have concluded that, while PROEX III, as such, allows Brazil to make PROEX III payments in such a way that they do not secure a material advantage in the field of export credit terms, PROEX III payments are not the payment by Brazil of "all or part of the costs incurred by exporters or financial institutions in obtaining credits". Brazil has, therefore, failed to demonstrate the required elements for its defence under the first paragraph of item (k). We have further concluded that, in any event, the first paragraph of item (k) cannot, as a legal matter, be invoked as an affirmative defence.

5.277 In the light of this, PROEX III, as such, is not "justified" under the first paragraph of item (k).

## VI. CONCLUSION

6.1 For the reasons set forth in this Report, we conclude that:

(a) It has not been established that PROEX III, as such, is inconsistent with Article 3.1(a) of the *SCM Agreement*;

(b) PROEX III, as such, is, in any event, justified under the second paragraph of item (k) of the Illustrative List of Export Subsidies contained in Annex I to the *SCM Agreement*;

(c) PROEX

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view that it is legally possible for Brazil to operate the PROEX III programme in such a way that it will:

(a) not result in a benefit being conferred on producers of regional aircraft and, hence, not constitute a *subsidy* within the meaning of Article 1.1 of the *SCM Agreement*; or

(b) result in a benefit being conferred on producers of regional aircraft, but conform to the requirements of the safe haven of the second paragraph of item (k), in which case it would not constitute a *prohibited* export subsidy within the meaning of Article 3.1 of the *SCM Agreement.*

6.3 We wish to be clear, however, that it does not necessarily follow from our conclusion that future application of the PROEX III programme will, likewise, be consistent with the *SCM Agreement.* It should be mentioned, in this regard, that Canada is free to challenge such future application in accordance with the provisions of the *DSU* if it considers it not to be in conformity with the *SCM Agreement.*

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