

**CANADA – CERTAIN MEASURES AFFECTING  
THE AUTOMOTIVE INDUSTRY**

**AB-2000-2**

*Report of the Appellate Body*



I.	Introduction .....	1
II.	The Measure and Its Background.....	3
III.	Arguments of the Participants and Third Participants.....	6
A.	<i>Claims of Error by Canada – Appellant</i> .....	6
1.	Article I:1 of the GATT 1994 .....	6
2.	Article 3.1(a) of the <i>SCM Agreement</i> .....	7
3.	Article I:1 and Article II:1 of the GATS .....	8
B.	<i>Arguments by the European Communities – Appellee</i> .....	9
1.	Article I:1 of the GATT 1994 .....	9
2.	Article 3.1(a) of the <i>SCM Agreement</i> .....	9
3.	Article I:1 and Article II:1 of the GATS .....	10
C.	<i>Arguments by Japan – Appellee</i> .....	11
1.	Article I:1 of the GATT 1994 .....	11
2.	Article 3.1(a) of the <i>SCM Agreement</i> .....	11
3.	Article I:1 and Article II:1 of the GATS .....	12
D.	<i>Claims of Error by the European Communities – Appellant</i> .....	13
1.	Article 3.1(a) of the <i>SCM Agreement</i> – European Communities' Claim Regarding CVA Requirements .....	13
2.	Article 3.1(b) of the <i>SCM Agreement</i> .....	13
E.	<i>Claims of Error by Japan – Appellant</i> .....	14
1.	Article 3.1(a) of the <i>SCM Agreement</i> .....	14
2.	Article 3.1(b) of the <i>SCM Agreement</i> .....	15
F.	<i>Arguments by Canada – Appellee</i> .....	16
1.	Article 3.1(a) of the <i>SCM Agreement</i> .....	16
2.	Article 3.1(b) of the <i>SCM Agreement</i> .....	17
G.	<i>Third Participants</i> .....	18
1.	Korea .....	18
2.	United States.....	20
IV.	Issues Raised in this Appeal.....	20
V.	Article I:1 of the GATT 1994.....	21

VI.	Article 3.1(a) of the <i>SCM Agreement</i> .....	27
	A. <i>Whether the Measure Constitutes a "Subsidy"</i> .....	27
	B. <i>Whether the Measure is "Contingent...in Law...upon Export Performance"</i> .....	30
VII.	Article 3.1(a) of the <i>SCM Agreement</i> - European Communities' Claim Regarding CVA Requirements .....	35
VIII.	Article 3.1(b) of the <i>SCM Agreement</i> .....	37
	A. <i>Whether the Measure is Contingent "in Law" Upon the Use of Domestic over Imported Goods</i> .....	37
	B. <i>Whether the Measure is Contingent "in Fact" Upon the Use of Domestic over Imported Goods</i> .....	44
IX.	Article I:1 and Article II:1 of the GATS .....	48
	A. <i>Article I:1 of the GATS</i> .....	48
	B. <i>Article II:1 of the GATS</i> .....	55
X.	Findings and Conclusions .....	60

WORLD TRADE ORGANIZATION  
APPELLATE BODY

**Canada – Certain Measures Affecting the  
Automotive Industry**

Canada, *Appellant/Appellee*

Japan, *Appellant/Appellee*

European Communities, *Appellant/Appellee*

Korea, *Third Participant*

United States, *Third Participant*

AB-2000-2

Present:

Ehlermann, Presiding Member

Bacchus, Member

Feliciano, Member

**I. Introduction**

1. Canada, the European Communities and Japan appeal certain issues of law and legal interpretations in the Panel Report, *Canada – Certain Measures Affecting the Automotive Industry* (the "Panel Report").<sup>1</sup> The Panel was established to consider a complaint by the European Communities and Japan with respect to a Canadian measure which provides a duty exemption for the importation of certain automobiles, buses and other specified commercial vehicles ("motor vehicles"). According to the Panel, the Canadian measure consists of the Motor Vehicles Tariff Order, 1998 (the "MVTO 1998") and Special Remission Orders (the "SROs") promulgated by the Government of Canada.<sup>2</sup> Pertinent aspects of the Canadian measure are described in Section II below.

2. The Panel considered claims by the European Communities and Japan that the measure is inconsistent with Article I:1 of the General Agreement on Tariffs and Trade 1994 (the "GATT 1994")<sup>3</sup>; with Article III:4 of the GATT 1994; with Article 2 of the *Agreement on Trade-Related Investment Measures* (the "TRIMs Agreement"); with the prohibition on export subsidies under Article 3.1(a) of the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement"); with the prohibition on subsidies contingent on the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*; with Article II of the General Agreement on Trade in Services

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<sup>1</sup>WT/DS139/R, WT/DS142/R, 11 February 2000.

<sup>2</sup>Panel Report, paras. 2.15-2.35.

<sup>3</sup>Japan argued that the inconsistency with Article I:1 of the GATT 1994 resulted from the treatment of all "motor vehicles", whereas the European Communities restricted its claim under this provision to the treatment of "automobiles". Panel Report, paras. 5.19, 6.9, 6.38 and 10.7.

(the "GATS")<sup>4</sup>; and with Article XVII of the GATS. The Panel Report was circulated to the Members of the World Trade Organization (the "WTO") on 11 February 2000.

3. The Panel concluded as follows: (a) that Canada acts inconsistently with Article I:1 of the GATT 1994; (b) that the inconsistency with Article I:1 of the GATT 1994 is not justified under Article XXIV of the GATT 1994; (c) that Canada acts inconsistently with Article III:4 of the GATT 1994, as a result of the application of the Canadian value added requirements; (d) that the European Communities and Japan failed to demonstrate that Canada acts inconsistently with Article III:4 of the GATT 1994, as a result of the application of the production-to-sales ratio requirements; (e) that Canada acts inconsistently with Article 3.1(a) of the *SCM Agreement*; (f) that the European Communities and Japan failed to demonstrate that Canada acts inconsistently with its obligations under Article 3.1(b) of the *SCM Agreement*; (g) that Canada acts inconsistently with Article II of the GATS; (h) that the inconsistency with Article II of the GATS is not justified by Article V of the GATS; (i) that Japan failed to demonstrate that the import duty exemption under the measure constitutes treatment less favourable accorded to Japanese suppliers of wholesale trade services of motor vehicles than that accorded to like Canadian service suppliers, within the meaning of Article XVII of the GATS; and (j) that Canada acts inconsistently with Article XVII of the GATS by according treatment less favourable to services and service suppliers of other Members than it accords to its own like services and service suppliers, as a result of the application of the Canadian value added requirements.<sup>5</sup>

4. With respect to its conclusions under Articles I:1 and III:4 of the GATT 1994, and Articles II and XVII of the GATS, the Panel recommended that the Dispute Settlement Body (the "DSB") request Canada to bring its measure into conformity with its obligations under the *WTO Agreement*. Having found that certain production-to-sales ratio requirements, imposed as one of the conditions for determining eligibility for the import duty exemption, are inconsistent with Article 3.1(a) of the *SCM Agreement*, the Panel recommended that Canada withdraw the subsidies within 90 days pursuant to Article 4.7 of the *SCM Agreement*.<sup>6</sup>

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<sup>4</sup>Japan argued that the inconsistency with Article II:1 of the GATS resulted from the treatment of all "motor vehicles", whereas the European Communities restricted its claim under this provision to the treatment of "automobiles". Panel Report, paras. 5.19, 6.710, 6.716 and 10.7.

<sup>5</sup>*Ibid.*, para. 11.1.

<sup>6</sup>*Ibid.*, para. 11.7.

5. On 2 March 2000, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 13 March 2000, Canada filed its appellant's submission.<sup>7</sup> On 17 March 2000, the European Communities and Japan each filed its own appellant's submission.<sup>8</sup> On 27 March 2000, Canada<sup>9</sup>, the European Communities and Japan<sup>10</sup> all filed appellees' submissions. On the same day, Korea and the United States each filed a third participant's submission.<sup>11</sup>

6. The oral hearing in the appeal was held on 6 and 7 April 2000. In the oral hearing, the participants and third participants presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

## II. The Measure and Its Background

7. The Canadian measure<sup>12</sup> at issue in this appeal is duty-free treatment provided to imports of automobiles, buses and specified commercial vehicles ("motor vehicles") by certain manufacturers under the Customs Tariff<sup>13</sup>, the Motor Vehicles Tariff Order, 1998 (the "MVTO 1998")<sup>14</sup> and the Special Remission Orders (the "SROs").<sup>15</sup> The conditions under which eligibility for the import duty exemption is determined are set out in the MVTO 1998, the SROs and certain Letters of Undertaking (the "Letters").<sup>16</sup>

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<sup>7</sup>Pursuant to Rule 21(1) of the *Working Procedures*.

<sup>8</sup>Pursuant to Rule 23(1) of the *Working Procedures*.

<sup>9</sup>Pursuant to Rule 23(3) of the *Working Procedures*.

<sup>10</sup>Pursuant to Rule 22 of the *Working Procedures*.

<sup>11</sup>Pursuant to Rule 24 of the *Working Procedures*.

<sup>12</sup>In this Report, we refer to this measure as either the "import duty exemption" or the "measure".

<sup>13</sup>S.C. 1997, c. 36.

<sup>14</sup>Under Canadian law, the MVTO 1998 is a regulation promulgated by the Governor-General-in-Council, on the recommendation of the Minister of Finance, under the authority of the Customs Tariff, S.C. 1997, c. 36, subsections 14(2) and 16. See Panel Report, footnote 24.

<sup>15</sup>The SROs are regulations promulgated by the Governor-General-in-Council, on the recommendation of the Minister of Finance and the Minister of Industry, under the authority of the Financial Administration Act, R.S.C. 1985, c. F-11, s. 23. *Ibid.*, footnote 25.

<sup>16</sup>The Letters were prepared and submitted by the Canadian subsidiaries of four automobile manufacturers to the Canadian Minister of Industry in January 1965 and commit these manufacturers to increase the amount of Canadian value added used by a specified percentage of each manufacturer's market share growth. These four companies were: General Motors of Canada, Ltd., Ford Motors Co. of Canada, Ltd., Chrysler Canada, Ltd., and American Motors (Canada) Ltd. *Ibid.*, paras. 10.92-10.95 and 10.128.

8. The MVTO 1998 has its origins in the Agreement Concerning Automotive Products Between the Government of Canada and the Government of the United States of America (the "Auto Pact")<sup>17</sup>, which was implemented domestically in Canada by the MVTO 1965 and the Tariff Item 950 Regulations. These legal instruments were replaced by the MVTO 1988 and later by the MVTO 1998. The MVTO 1998 is in effect today.<sup>18</sup>

9. Under the MVTO 1998, the import duty exemption is available to manufacturers of motor vehicles on imports "from any country entitled to the Most-Favoured-Nation Tariff"<sup>19</sup>, if the manufacturer meets the following three conditions: (1) it must have produced in Canada, during the designated "base year", motor vehicles of the class imported; (2) the ratio of the net sales value of the vehicles *produced in Canada* to the net sales value of all vehicles of that class *sold* for consumption *in Canada* in the period of importation must be "equal to or higher than" the ratio in the "base year", and the ratio shall not in any case be lower than 75:100 (the "ratio requirements"); and (3) the amount of Canadian value added in the manufacturer's local production of motor vehicles must be "equal to or greater than" the amount of Canadian value added in the local production of motor vehicles of that class during the "base year" (the "CVA requirements").<sup>20</sup>

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<sup>17</sup>See 4 International Legal Materials, p. 302. The Auto Pact was concluded in 1965. Under Article II(a) of the Auto Pact, Canada agreed to accord an import duty exemption to imports from the United States of certain products listed in Annex A of the Auto Pact. In order to receive the import duty exemption, a company had to meet three conditions set out in paragraph 2(5) of Annex A: (1) it must have produced in Canada, during the "base year", motor vehicles of the class it was importing; (2) the ratio of the net sales value of its production in Canada to the net sales value of motor vehicles of that class sold for consumption in Canada must have been "equal to or higher than" the ratio during the "base year", and could in no case be lower than 75:100; and (3) the Canadian value added in the company's local production in Canada of motor vehicles must have been "equal to or greater than" Canadian value added in motor vehicles of that class during the "base year". Pursuant to Article V of the Auto Pact, Canada extended the benefits of this import duty exemption to other countries, but the United States did not. Canada also was allowed, under paragraph 3 of Annex A of the Auto Pact, to designate additional manufacturers as beneficiaries of the import duty exemption, even though the manufacturers did not meet the Auto Pact conditions. The Canada-United States Free Trade Agreement (the "CUSFTA"), which entered into force on 1 January 1989, provides, in Article 1001, for the continued administration of the Auto Pact. 27 International Legal Materials, p. 281. However, pursuant to Article 1002.1 and the Annex to Article 1002.1 of the CUSFTA, the Government of Canada could no longer designate additional manufacturers who would benefit from the import duty exemption. The CUSFTA was suspended with the 1 January 1994 entry into force of the North American Free Trade Agreement (the "NAFTA"), which, under Appendix 300-A.1, allows Canada to maintain the import duty exemption subject to the conditions stipulated in the CUSFTA. 32 International Legal Materials, p. 605.

<sup>18</sup>Panel Report, para. 2.15.

<sup>19</sup>MVTO 1998, Schedule, Part 1, para. 2. In para. 10.160 of the Panel Report, the Panel recalled "that Canada applies an MFN duty on motor vehicles originating in non-NAFTA countries at the rate of 6.1 per cent."

<sup>20</sup>*Ibid.*, para. 1(1), definition of "manufacturer". A list of beneficiaries of the MVTO 1998 is contained in the Appendix to Memorandum D-10-16-3, issued by the Ministry of National Revenue on 10 April 1995. This Appendix lists a total of 33 firms, of which four are identified as automobile manufacturers, seven as bus manufacturers, and 27 as manufacturers of specified commercial vehicles. Panel Report, para. 2.21.



10. The Panel found that, as a matter of fact, the average ratio requirements applicable to the MVTO 1998 beneficiaries are "as a general rule" 95:100 for automobiles, and "at least" 75:100 for buses and specified commercial vehicles.<sup>21</sup>

11. The MVTO 1998 states that the CVA used by a particular manufacturer shall be calculated based on the "aggregate" of certain listed costs of production, which are, broadly speaking:

- the cost of parts produced in Canada and of materials of Canadian origin that are incorporated in the motor vehicles;
- transportation costs;
- labour costs incurred in Canada;
- manufacturing overhead expenses incurred in Canada;
- general and administrative expenses incurred in Canada that are attributable to the production of motor vehicles;
- depreciation in respect of machinery and permanent plant equipment located in Canada that is attributable to the production of motor vehicles; and
- a capital cost allowance for land and buildings in Canada that are used in the production of motor vehicles.<sup>22</sup>

12. Through the SROs, Canada has also designated certain other companies, in addition to those qualifying under the MVTO 1998, as eligible to import motor vehicles duty-free.<sup>23</sup> Canada promulgated the SROs under the authority of the Financial Administration Act for certain companies that had not met the original conditions of the MVTO 1965.<sup>24</sup> The SROs entitle motor vehicles imported by these companies to receive the import duty exemption as long as they meet certain designated conditions. Specifically, the SROs provide for the remission of duties on imports of motor vehicles where conditions relating to certain specified production-to-sales ratio requirements and CVA requirements are fulfilled.

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<sup>21</sup>Panel Report, para. 10.182.

<sup>22</sup>*Ibid.*, para. 2.26; MVTO 1998, Schedule, Part 1, para. 1(1), definition of "Canadian value added", letter (a).

<sup>23</sup>Auto Pact, para. 3 of Annex A; Panel Report, para. 2.3. An administrative memorandum of Revenue Canada lists 63 firms as beneficiaries under the SROs, of which two are identified as automobile manufacturers, five as bus manufacturers, and 59 as manufacturers of specified commercial vehicles. Panel Report, para. 2.31.

<sup>24</sup>Panel Report, footnote 25.

13. With respect to the actual ratio and CVA requirements under the SROs, each SRO sets out specific ratio and CVA requirements to be met by the company receiving the SRO. For ratio requirements, the SROs issued before 1977 set the production-to-sales ratios at 75:100. Since then, almost all SROs have set ratios at 100:100.<sup>25</sup> For CVA, requirements under the SROs range from 40 to 60 per cent, as follows: SROs issued before 1984 stipulate that, during an initial period of one or two years, the CVA must be at least 40 per cent of the cost of production. After that initial period, the CVA should be at least the same (in dollar terms) as in the last 12 months of the initial period; however, the CVA must not, in any case, be less than 40 per cent of the cost of production. For SROs issued after 1984, the CVA shall be no less than 40 per cent of the cost of sales of vehicles sold in Canada, with the exception of the manufacturer CAMI Automotive Inc. ("CAMI"), for which the CVA level is set at 60 per cent.<sup>26</sup>

14. In accordance with its obligations under the CUSFTA, since 1989, Canada has not designated any additional manufacturers to be eligible for the import duty exemption under the MVTO 1998, nor has Canada promulgated any new SROs. Also, the MVTO 1998 specifically excludes vehicles imported by a manufacturer which did not qualify before 1 January 1988.<sup>27</sup> Thus, the list of manufacturers eligible for the import duty exemption is closed.

### **III. Arguments of the Participants and Third Participants**

#### *A. Claims of Error by Canada – Appellant*

##### 1. Article I:1 of the GATT 1994

15. Canada argues that the Panel erred in finding that the Canadian measure is inconsistent with the most-favoured-nation ("MFN") provisions of Article I:1 of the GATT 1994. By its terms, Article I:1 prohibits discrimination in the according of advantages based on the origin of products. In Canada's view, the Canadian measure at issue is "origin-neutral"<sup>28</sup> in this sense, and is therefore consistent with Article I:1.

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<sup>25</sup>Panel Report, para. 2.34.

<sup>26</sup>*Ibid.*, para. 2.33.

<sup>27</sup>MVTO 1998, Schedule, Part 1, para. 3.

<sup>28</sup>Canada's appellant's submission, para. 163.

16. Canada submits that none of the previous panel reports addressing the issue of MFN treatment under Article I:1 supports the Panel's concept of a *de facto* violation of Article I:1. The facts of the present case are different from those in previous cases. In this case, motor vehicles imported duty-free into Canada come from numerous countries, and the conditions for receiving the import duty exemption have nothing to do with the origin of those vehicles.

2. Article 3.1(a) of the *SCM Agreement*

(a) *Whether the Measure Constitutes a "Subsidy"*

17. According to Canada, the Canadian measure does not fall within the definition of "subsidy" in Article 1.1 of the *SCM Agreement*. Canada argues that the appropriate test for whether the measure is a "subsidy" is to apply the text of Article 1.1 of the *SCM Agreement*, in its context, and in the light of the object and purpose of the *WTO Agreement*. With respect to context, the meaning of Article 1.1(a)(ii) is circumscribed by footnote 1 of the *SCM Agreement*. This footnote demonstrates that the waiver of import duties for a product will not always be deemed to be a "subsidy". The key element in determining whether a measure is a "subsidy" is that the amount of the duty waived cannot be in excess of the duty amount accrued. The Canadian measure is analogous to the situation described in footnote 1 of the *SCM Agreement*. As there can never be a duty exemption in excess of the amount of the duty that would have accrued, the duty exemption is not a "subsidy" under Article 1.1 of the *SCM Agreement*.

(b) *Whether the Measure is "Contingent...in Law...upon Export Performance"*

18. Canada argues that the measure is not contingent "in law" upon export performance under Article 3.1(a) of the *SCM Agreement*. The Panel did not even attempt to demonstrate contingency "on the basis of the words of the relevant legislation". Rather, the Panel resorted to hypothetical "facts". By examining these "facts", the Panel shifted its analysis away from contingency "in law" to contingency "in fact".

19. Canada notes that the Panel found that the import duty exemption is contingent upon exportation because the exemption is conditional on meeting certain production-to-sales ratios. The Panel grouped these ratios into two categories: ratios below one to one, and ratios of one to one or higher. Canada argues that neither of these two categories of ratios results in export contingency "in fact".

3. Article I:1 and Article II:1 of the GATS

(a) *Article I:1 of the GATS*

20. According to Canada, the Panel erred in finding that the scope of the GATS extends to the measure at issue. Canada argues that the scope of the GATS is established in Article I of that Agreement, which states that the Agreement applies to "measures...affecting trade in services." Canada submits that the measure at issue does not affect trade in services. In this case, Canada contends, the measure does not affect the supply of distribution services and does not affect wholesale distribution service suppliers in their capacity as service suppliers. It is true that the import duty exemption "may affect"<sup>29</sup> the cost of the goods. However, any effect this may have on the supply of distribution services is so "tenuous"<sup>30</sup> that the measure clearly falls within the category of measures that should be scrutinized exclusively under the GATT 1994.

(b) *Article II:1 of the GATS*

21. Canada submits that the complainants have claimed both *de jure* and *de facto* discrimination under Article II:1 of the GATS. To find for the complainants, the Panel was required to set out the basis on which the measure accords less favourable treatment to certain services and service suppliers, and to show how this less favourable treatment is accorded to the like services or service suppliers of certain Members. In Canada's view, the Panel's analysis does not demonstrate either of these.

22. Canada argues that it appears the Panel found discrimination against services and service suppliers of "any other Member" on the basis that the import duty exemption was granted to *certain* manufacturers of *some* Members, even though the qualification for this treatment was based on "origin-neutral"<sup>31</sup> criteria. This finding is problematic because it implies that unless all manufacturers of all Members satisfy the criteria applied for eligibility for the import duty exemption, discrimination will always be found. Under the Panel's reasoning, there would be discrimination whenever a manufacturer of a Member was not represented among the qualifying service suppliers. Furthermore, Canada states that the Panel's analysis of Article II:1 ignores the fact that the nationality of the manufacturers/wholesalers can be modified by private commercial decisions.

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<sup>29</sup>Canada's appellant's submission, para. 115.

<sup>30</sup>*Ibid.*

<sup>31</sup>*Ibid.*, para. 163.

B. *Arguments by the European Communities – Appellee*

1. Article I:1 of the GATT 1994

23. In the view of the European Communities, the Panel's interpretation of Article I:1 of the GATT 1994 is correct. Although the measure at issue in this case applies to importers and is, on its face, origin-neutral, the Panel found that, nevertheless, such a measure could accord a *de facto* advantage to products originating in certain countries.

24. The European Communities argues that *de facto* inconsistency with Article I:1 of the GATT 1994 must be established on a case-by-case basis. When examining a claim of *de facto* violation, it is necessary to take into account all relevant facts, and infer inconsistency from the total configuration of the facts. In this case, the Panel correctly found that the relevant facts establish that *de facto* inconsistency exists.

2. Article 3.1(a) of the SCM Agreement

(a) *Whether the Measure Constitutes a "Subsidy"*

25. The European Communities considers that the Panel was correct in finding that the measure constitutes a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*. Article 1.1(a)(ii) considers as a "financial contribution" the situation in which government revenue that is "otherwise due" is foregone. In this case, the Canadian government established a normative benchmark for its customs duties, which constitute government revenue. The import duty exemption is a departure from this norm. Therefore, the measure constitutes government revenue "otherwise due" that has been foregone and, consequently, is a "financial contribution". As the measure also confers a "benefit" under Article 1.1(b), it is a "subsidy".

(b) *Whether the Measure is "Contingent...in Law...upon Export Performance"*

26. The European Communities argues that the Panel correctly concluded that the words of the relevant legal instruments demonstrate that the production-to-sales ratio requirements make the measure contingent "in law" upon export performance, in contravention of Article 3.1(a) of the *SCM Agreement*. The standard for *de jure* inconsistency encompasses both legal instruments that provide for *express* export contingency, as well as *implicit* export contingency, that is, where the requirement to export is a necessary consequence arising from the operation of conditions stated in the law. The present case falls into the latter category.

27. In the view of the European Communities, production-to-sales ratio requirements of both one to one or greater, and of less than one to one, result in export contingency "in law". Where the ratio requirements are one to one or greater, the manufacturer concerned cannot sell any value of motor vehicles brought into Canada under the import duty exemption unless it exports an equivalent value. Where the ratio requirements are less than one to one, the European Communities agrees with Canada that the manufacturer concerned is entitled to sell a certain value of motor vehicles imported under the import duty exemption without exporting. However, the European Communities points out that, if the manufacturer does export, the value of imports made under the import duty exemption will increase by an amount equal to the value of the exports. Therefore, the measure is contingent "in law" upon export performance as a result of the ratio requirements, in contravention of Article 3.1(a) of the *SCM Agreement*.

3. Article I:1 and Article II:1 of the GATS

(a) *Article I:1 of the GATS*

28. According to the European Communities, the Panel's finding that the Canadian measure affects trade in services under Article I of the GATS was correct. While it is true that the measure in this case can affect both goods and services, this does not mean that the measure cannot be examined under the GATS. The European Communities maintains that the proper test under Article I:1 of the GATS is simply whether the measure at issue affects the supply of services and that the Panel's examination of the measure under Article II of the GATS implicitly included an assessment of whether the measure affects trade in services under Article I of the GATS.

(b) *Article II:1 of the GATS*

29. In the view of the European Communities, Article II of the GATS applies to *de facto* as well as *de jure* discrimination. When examining a claim of *de facto* discrimination, any inconsistency must be inferred from the total configuration of the facts surrounding the measure. In this case, the Panel properly examined these facts, and these facts support its finding that *de facto* discrimination exists.

30. The European Communities submits that the Panel correctly found that the Canadian measure accords less favourable treatment to services and service suppliers of some Members than it accords to like services and service suppliers of other Members. The European Communities argues that, contrary to Canada's claim, vertical integration in the automotive industry does not preclude the

possibility that competitive conditions for the provision of wholesale trade services would be affected by the measure. The Panel's finding that vertical integration did not exclude potential competition in wholesaler-manufacturer relationships nor actual competition in wholesaler-retailer relationships was correct. This finding is confirmed by the fact that the vast majority of the service suppliers receiving the import duty exemption under the measure are from the United States. Furthermore, eligibility for the import duty exemption has been closed, since 1989, to any additional service suppliers.

C. *Arguments by Japan – Appellee*

1. Article I:1 of the GATT 1994

31. Japan maintains that the Panel's finding that the Canadian measure is inconsistent with Article I:1 of the GATT 1994 was correct. The Panel interpreted Article I:1 properly through an analysis of whether the Canadian measure accorded, *de facto*, less favourable treatment to like products of certain WTO Members. The Panel took into account the possibility that the limitation of the import duty exemption under the measure to certain importers resulted in *de facto* discrimination.

32. In Japan's view, the facts of this case demonstrate that the measure is an "advantage" under Article I:1 of the GATT 1994 that is available for imports of motor vehicles originating in some countries, but is not available with respect to imports of like motor vehicles originating in *all* WTO Members. This discrimination arises because eligibility for the import duty exemption is restricted to a limited group of manufacturers, as well as because of the intra-firm purchasing practices of the industry. Accordingly, the Panel properly concluded that the Canadian measure was inconsistent with Article I:1 of the GATT 1994.

2. Article 3.1(a) of the *SCM Agreement*

(a) *Whether the Measure Constitutes a "Subsidy"*

33. According to Japan, the Panel correctly found that the measure constitutes a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*. The findings that the measure constitutes a "financial contribution" because government revenue "otherwise due" has been foregone, and that a "benefit" also exists, support the Panel's conclusion that a "subsidy" exists.

(b) *Whether the Measure is "Contingent...in Law...upon Export Performance"*

34. Japan considers that the measure is contingent "in law" upon export performance under Article 3.1(a) of the *SCM Agreement*. As a result of the ratio requirements, there is a clear relationship of conditionality between the import duty exemption and exportation. Japan argues that where the ratio requirement is set at one to one or higher, there is a requirement to export in order to receive the import duty exemption. The only "economically viable"<sup>32</sup> way for a manufacturer to comply with the ratio requirements when it imports motor vehicles is to export vehicles that it has produced in Canada. Where the ratio requirement is less than one to one, the requirement to export also arises, even though, Japan concedes, the "pressure" to export is of a "lesser degree"<sup>33</sup> in this situation. Japan has provided mathematical expressions of these arguments.

35. According to Japan, the Panel's finding that the ratio requirements, as a condition for receiving the import duty exemption, are contingent "in law" upon export performance was correct, since contingency can be established based on the words of the relevant legal instruments. Those instruments create a "construct"<sup>34</sup> under which the import duty exemption under the measure is contingent upon export performance. Therefore, the measure is contingent "in law" upon export performance under Article 3.1(a) of the *SCM Agreement*.

3. Article I:1 and Article II:1 of the GATS

(a) *Article I:1 of the GATS*

36. In Japan's view, the Panel's approach in determining whether the application of the measure affects trade in services within the meaning of Article I of the GATS is correct. The Panel did not err in its substantive finding that the measure affects trade in services under Article I of the GATS. The term "affecting" in Article I has a broad reach. The measure affects trade in services, as it has an effect on the "cost and/or profitability"<sup>35</sup> of the related wholesale trade services.

(b) *Article II:1 of the GATS*

37. Japan argues that the measure is inconsistent with the MFN obligation in Article II of the GATS. The Panel's finding in this regard is correct. The Panel relied, in part, on the fact that the measure put some service providers at an economic or competitive disadvantage. The Panel

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<sup>32</sup>Japan's appellee's submission, para. 71.

<sup>33</sup>*Ibid.*, para. 73.

<sup>34</sup>*Ibid.*, para. 85.

<sup>35</sup>*Ibid.*, para. 113.



recognized that two elements of the provision of wholesale services must be examined: wholesale services provided to manufacturers, and wholesale services provided to retailers. In Japan's view, the Panel made the correct finding under Article II of the GATS, that the import duty exemption is only available to certain wholesale service suppliers, and is therefore not made available to like service suppliers of all WTO Members.

D. *Claims of Error by the European Communities – Appellant*

1. Article 3.1(a) of the SCM Agreement – European Communities' Claim Regarding CVA Requirements

38. According to the European Communities, the Panel failed to address the European Communities' claim that the CVA requirements operate as an export performance condition prohibited by Article 3.1(a) of the *SCM Agreement*. The European Communities claimed before the Panel that the CVA requirements make the subsidy contingent "in law" and, alternatively, "in fact" upon the use of domestic over imported goods or, as the sole alternative, upon export performance.<sup>36</sup> Therefore, the CVA requirements are inconsistent with the prohibition of Article 3.1(a). The Panel's failure to address the alternative condition of export performance was an error. The European Communities requests the Appellate Body to find that certain of the CVA requirements are contingent upon export performance.

2. Article 3.1(b) of the SCM Agreement

(a) *Whether the Measure is Contingent "in Law" upon the Use of Domestic over Imported Goods*

39. The European Communities argues that Article 3.1(b) of the *SCM Agreement* prohibits subsidies contingent upon a condition that "gives preference"<sup>37</sup> to the use of domestic over imported goods. The Panel's narrow finding that Article 3.1(b) only prohibits the granting of subsidies that "require" the beneficiary to "actually use" domestic goods constitutes legal error.<sup>38</sup> In the European Communities' view, the Panel's interpretation would allow circumvention of Article 3.1(b). Furthermore, even applying the test used by the Panel, the CVA requirements do in certain circumstances require the actual use of domestic goods as a matter of law. Therefore, the Panel's finding is in error.

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<sup>36</sup>The claims can be found in the Panel Report, at paras. 6.497-6.500, 6.620 and 6.690.

<sup>37</sup>European Communities' appellant's submission, para. 23.

<sup>38</sup>*Ibid.*, para. 28.

40. The European Communities notes that Article 3.1(b) prohibits the granting of subsidies that are contingent upon the use of domestic over imported goods "whether solely or as one of several conditions". These terms cover the situation where a subsidy is simultaneously subject to two or more "cumulative conditions". However, the European Communities argues that these terms may also apply where a subsidy is subject to two or more "alternative" conditions, where compliance with any one or more of them gives a right to obtain the subsidy.<sup>39</sup> According to the European Communities, the use of domestic over imported goods through the CVA requirements is an alternative condition for receiving the import duty exemption under the measure. This alternative condition is a condition "in law" for receiving the import duty exemption, and is, therefore, inconsistent with Article 3.1(b) of the *SCM Agreement*.

(b) *Whether the Measure is Contingent "in Fact" upon the Use of Domestic over Imported Goods*

41. In the alternative, the European Communities argues that the CVA requirements constitute a subsidy contingent "in fact" upon the use of domestic over imported goods. In making this claim, the European Communities contends that the Panel's finding that Article 3.1(b) does not apply to "in fact" contingency is erroneous.

42. In the European Communities' view, the Panel's finding was in error as it relied solely on one aspect of the context of Article 3.1(b), while ignoring the ordinary meaning, other contextual aspects, the object and purpose, and the drafting history of the provision. The ordinary meaning of Article 3.1(b) does not exclude contingency "in fact". Also, it is relevant as context that Article 3.1(b) was inserted into the *SCM Agreement* to clarify and reinforce existing GATT 1994 disciplines with respect to local content requirements. Furthermore, the object and purpose of Article 3.1(b) is to prevent the use of subsidies which promote the substitution of domestic for imported goods. If the Panel's interpretation were followed, the prohibitions in Article 3.1(b) could be circumvented.

E. *Claims of Error by Japan – Appellant*

1. Article 3.1(a) of the *SCM Agreement*

(a) *Whether the Measure is "Contingent...in Law...upon Export Performance"*

43. Japan conditionally appeals the Panel's decision not to make a finding with respect to whether the measure is "in fact" contingent upon export performance in contravention of Article 3.1(a) of the *SCM Agreement*. In the event the Appellate Body overturns the Panel's finding that the subsidy is

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<sup>39</sup>European Communities' appellant's submission, para. 44.

contingent "in law" upon export performance, Japan submits that the Panel's use of judicial economy was in error, and the issue of whether the subsidy is contingent "in fact" upon export performance should be considered by the Appellate Body.

44. According to Japan, the Panel made certain findings relevant to the issue of whether the import duty exemption is contingent "in fact" upon export performance. The Panel's examination of the ratio requirements demonstrates that the "facts" of those requirements lead to the conclusion that the import duty exemption is contingent upon export performance.

2. Article 3.1(b) of the *SCM Agreement*

(a) *Whether the Measure is Contingent "in Law" upon the Use of Domestic over Imported Goods*

45. Japan argues that the measure is contingent "in law" upon the use of domestic over imported goods, in contravention of Article 3.1(b) of the *SCM Agreement*. The plain language of this provision demonstrates that a "key component" of the applicable legal standard is whether the use of domestic over imported goods "would lead to" the granting or maintenance of a subsidy.<sup>40</sup> This interpretation is supported by the object and purpose of the *SCM Agreement* as a whole and of Article 3.1(b) in particular.

46. Japan submits that, in this case, the use of CVA is one of several conditions that, if fulfilled, results in the receipt of the import duty exemption. One way to meet the CVA requirements is to use domestic parts and materials. According to Japan, it has *not* been demonstrated that the CVA requirements can be met without using domestic parts and materials. The Panel has referred to the *hypothetical* possibility to do so, but Canada has not provided sufficient evidence to rebut the fact that the CVA requirements mandate the use of domestic parts and materials. The Panel's finding that a subsidy is not contingent on the use of domestic over imported goods if it can be obtained through other means, although the use of domestic over imported goods is one way actually to obtain the subsidy, is problematic. If this finding is upheld, it will be possible for WTO Members to escape their Article 3.1(b) obligations by including additional conditions that are unrelated to the use of domestic over imported goods.

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<sup>40</sup>Japan's appellant's submission, para. 7.

(b) *Whether the Measure is Contingent "in Fact" upon the Use of Domestic over Imported Goods*

47. Japan argues that Article 3.1(b) of the *SCM Agreement* prohibits both subsidies contingent "in law" and subsidies contingent "in fact" upon the use of domestic over imported goods. The Panel's finding restricting the scope of application of Article 3.1(b) to subsidies contingent "in law" was erroneous. The Panel found that the inclusion of the words "in law or in fact" in paragraph (a) of Article 3.1 of the *SCM Agreement* and the absence of the same words in paragraph (b) of the same Article means that the drafters of Article 3.1(b) intended to limit that provision to contingency "in law". In Japan's view, the Panel's reasoning ignores the ordinary meaning of the words of Article 3.1(b). Article 3.1(b) prohibits subsidies "contingent ... upon the use of domestic over imported goods." These words do not expressly limit the scope of coverage of Article 3.1(b) to contingency "in law". In the absence of an express limitation, Article 3.1(b) must be interpreted to apply to both contingency "in law" and "in fact". The inclusion of the words "in law or in fact" in Article 3.1(a) is most likely intended to "anchor"<sup>41</sup> footnote 4 of the *SCM Agreement*, which sets forth an explanation of subsidies contingent "in fact" upon export performance. In addition, the Panel's finding that Article 3.1(b) prohibits only subsidies contingent "in law" upon the use of domestic over imported goods does not take into account the object and purpose of the *WTO Agreement* as a whole and of Article 3.1(b) of the *SCM Agreement*.

48. According to Japan, when determining whether a subsidy is contingent "in fact" upon the use of domestic over imported goods, the issue is whether the configuration of the facts surrounding the granting of the subsidy is such that, "in fact", the subsidy will be granted if the recipient used domestic over imported goods. In the case of the measure at issue here, the relevant facts establish that it is impossible for manufacturers to satisfy the CVA requirements without purchasing at least a certain proportion of Canadian parts and components.

F. *Arguments by Canada – Appellee*

1. Article 3.1(a) of the *SCM Agreement*

(a) *Whether the Measure is "Contingent...in Fact...upon Export Performance"*

49. According to Canada, the Panel correctly applied the principle of judicial economy when it declined to examine whether the measure was contingent "in fact" upon export performance under Article 3.1(a) of the *SCM Agreement*. Since the Panel found that contingency "in law" existed, the

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<sup>41</sup>Japan's appellant's submission, para. 29.

Panel was entitled to stop its analysis there. This is a legitimate application of judicial economy, which Canada's appeal does not change. However, if the Appellate Body agrees with Canada's contention on the issue of contingency "in law", the question of whether the measure is contingent "in fact" upon export performance will become an issue.

50. With regard to the substance of Japan's appeal, Canada relies on the arguments made in its appellant's submission on this issue. In that submission, Canada argued that there is no evidence to demonstrate that the measure is "in fact" contingent upon export performance.<sup>42</sup>

(b) *European Communities' Claim Regarding CVA Requirements*

51. Canada refers to the argument of the European Communities that the CVA requirements, as a condition for receiving the import duty exemption, are, in the alternative, contingent upon exportation. Canada contends that the European Communities has not identified any error of law in the Panel's decision not to make a finding on this issue. Furthermore, the CVA requirements do not result in a subsidy which is contingent upon export performance, either "in law" or "in fact". Nothing in the text of the measure suggests that the measure is contingent upon export performance, nor is there any factual evidence to show that the granting of the subsidy was in any way tied to exportation, in contravention of Article 3.1(a) of the *SCM Agreement*.

2. Article 3.1(b) of the *SCM Agreement*

(a) *Whether the Measure is Contingent "in Law" upon the Use of Domestic over Imported Goods*

52. In Canada's view, the Panel was correct in finding that the measure is not contingent "in law" upon the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*. The Panel's interpretation of the word "contingent" was appropriate. By contrast, the European Communities and Japan seek to expand the scope of this term beyond its ordinary meaning. Both complainants argue that Article 3.1(b) of the *SCM Agreement* prohibits any condition that "favours", or gives "preference" to, the use of domestic goods. Canada responds that there is no basis for such an interpretation in the text of Article 3.1(b).

53. Canada submits that the argument by the complainants that Article 3.1(b) prohibits subsidies that may be received if one of several alternative conditions is fulfilled is without merit. In Canada's view, the complainant's position is at odds with the ordinary meaning of "contingent". If the use of domestic over imported goods were one of several alternative conditions for receiving a subsidy, that

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<sup>42</sup>*Supra*, para. 19.

subsidy would, by definition, not be "contingent" upon the use of domestic over imported goods, since it could be received without using domestic over imported goods.

(b) *Whether the Measure is Contingent "in Fact" upon the Use of Domestic over Imported Goods*

54. Canada considers, moreover, that Article 3.1(b) does not extend to measures that are "in fact" contingent upon the use of domestic over imported goods. The Panel's finding on this issue was correct. In Canada's view, the context provided by Article 3.1(a) is determinative. As the words "in law or in fact" are included in Article 3.1(a), the fact that they are not found in Article 3.1(b) indicates that Article 3.1(b) does not apply to contingency "in fact".

55. In any event, Canada argues, Japan and the European Communities have failed to establish that the measure is contingent "in fact" upon the use of domestic over imported goods. As evidence provided by Canada to the Panel demonstrates, it is not impossible to meet the CVA requirements without using Canadian goods.

G. *Third Participants*

1. Korea

(a) *Article I:1 of the GATT 1994*

56. Korea argues that the Canadian measure is inconsistent with Article I:1 of the GATT 1994 because it discriminates with respect to the treatment of like products of different origins. Although the measure does not, on its face, impose conditions relating to the origin of the products at issue, in practice the import duty exemption has not been accorded to like products originating in all WTO Members. In Korea's view, the Panel properly found that the limitation on eligibility for the import duty exemption to certain importers, in combination with the "intra-firm" character of trade in automotive products, results in *de facto* discrimination against like products from certain WTO Members.

(b) *Article 3.1(a) of the SCM Agreement*

(i) *Whether the Measure Constitutes a "Subsidy"*

57. According to Korea, the measure is a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*. Customs duties constitute government revenue, and the act of exempting payment of customs duties is an exception to the normal rules. Accordingly, the measure results in government

revenue foregone which is "otherwise due", under Article 1.1(a)(1)(ii). Since a benefit is conferred as a result, the measure is a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*.

(ii) Whether the Measure is "Contingent...in Law...upon Export Performance"

58. Korea contends that, as found by the Panel, the measure is contingent "in law" upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* as a result of the operation of the ratio requirements. The Panel was correct in its finding that the import duty exemption is contingent upon export performance, regardless of the specific ratio requirements. When the ratio requirements are 100:100 or higher, the import duty exemption cannot be received unless the company exports. When the ratio requirements are less than 100:100, the value of the imports which can be made under the measure is still directly contingent upon the value of exports. This conclusion results from the words of the relevant legal instruments themselves. Therefore, the measure is contingent "in law" upon export performance, under Article 3.1(a) of the *SCM Agreement*.

(c) *Article 3.1(b) of the SCM Agreement*

59. In Korea's view, the Panel erred in its conclusion that the measure does not constitute a subsidy that is contingent "in law" upon the use of domestic over imported goods under the terms of Article 3.1(b) of the *SCM Agreement*, as a result of the operation of the CVA requirements. The CVA requirements are one of several conditions for receiving the import duty exemption. The CVA requirements themselves may be satisfied by the use of Canadian goods, Canadian inputs other than goods, or some combination of the two. Since the use of Canadian goods is one of the means by which to meet the CVA requirements, the measure is contingent "in law" upon the use of domestic over imported goods, within the meaning of Article 3.1(b) of the *SCM Agreement*.

(d) *Article I:1 and Article II:1 of the GATS*

(i) Article I:1 of the GATS

60. Korea argues that, under Article I of the GATS, the scope of the GATS extends to the Canadian measure. The term "affecting" in Article I:1 of the GATS has a broad reach. In this case, although the measure does not directly govern the supply of services, it nevertheless modifies conditions of competition in the supply of wholesale trade services. It therefore falls within the scope of the GATS.

(ii) Article II:1 of the GATS

61. Korea submits that the Panel was correct in finding that the measure is inconsistent with Article II:1 of the GATS because it does not accord treatment no less favourable to like services and service suppliers of other WTO Members. Through its effect on the conditions of competition, the measure results in *de facto* discrimination based on the origin of the service or service supplier. In fact, the closed category of service suppliers is comprised almost exclusively of service suppliers of the United States and Canada. As a result, some motor vehicle service suppliers of some Members can receive the import duty exemption, while those of other Members cannot, and, consequently, service suppliers of certain Members receive less favourable treatment than service suppliers of other Members.

2. United States

62. In its submission, the United States notes that it "has a strong interest in the systemic implications of the issues presented in this appeal."<sup>43</sup> However, the United States does not make specific arguments on the substantive issues involved. As a result, no arguments made by the United States are summarized in this Section of the Report.

**IV. Issues Raised in this Appeal**

63. This appeal raises the following issues:

- (a) whether the Panel erred in concluding that Canada acts inconsistently with Article I:1 of the GATT 1994 by according the advantage of duty-free treatment to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members;
- (b) whether the Panel erred in concluding that Canada acts inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement* by granting a subsidy which is contingent in law upon export performance, as a result of the application of the ratio requirements as one of the conditions determining eligibility for the import duty exemption for motor vehicles under the MVTO 1998 and the SROs;

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<sup>43</sup>United States' appellant's submission, p.1.



- (c) whether the Panel erred in failing to address the European Communities' alternative claim that the import duty exemption, as a result of the application of the CVA requirements as one of the conditions for the import duty exemption, is a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*;
- (d) whether the Panel erred in concluding that the European Communities and Japan have failed to demonstrate that Canada acts inconsistently with its obligations under Article 3.1(b) of the *SCM Agreement* by granting a subsidy which is contingent upon the use of domestic over imported goods, as a result of the application of the CVA requirements as one of the conditions determining eligibility for the import duty exemption for motor vehicles under the MVTO 1998 and the SROs; and
- (e) whether the Panel erred in its interpretative approach with respect to Article I of the GATS; and in concluding that Canada acts inconsistently with Article II of the GATS by failing to accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country, with respect to the granting of the import duty exemption to a limited number of manufacturers/wholesalers of motor vehicles pursuant to the MVTO 1998 and the SROs.

## V. Article I:1 of the GATT 1994

64. Canada appeals the Panel's conclusion that Canada acts inconsistently with Article I:1 of the GATT 1994 by according the advantage of duty-free treatment to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, without according that advantage immediately and unconditionally to like motor vehicles originating in the territories of all other WTO Members.<sup>44</sup>

65. Canada argues that the Panel erred in the way it applied Article I:1 to the measure. In Canada's view, the Panel "simply determined that Article I:1 of the GATT 1994 contemplated *de facto* discrimination and proceeded to consider several factors without providing any legal justification for the scope of its inquiry."<sup>45</sup> These factors included, for Canada, irrelevant empirical data about the market for motor vehicles and the historical aspects of the measure.<sup>46</sup> Instead, Canada

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<sup>44</sup>Canada's appellant's submission, paras. 1-2.

<sup>45</sup>*Ibid.*, para. 20.

<sup>46</sup>*Ibid.*, para. 21.

considers that the Panel should have based its inquiry on a proper interpretation of the language of Article I:1, and on WTO law and practice.<sup>47</sup>

66. As Canada sees it, Article I:1 does not prohibit the imposition of "origin-neutral terms and conditions on importation that apply to *companies* as opposed to the *products they import*." Canada contends that terms are origin-neutral if they "do not impose limitations with respect to the origin of products that may be imported by those companies."<sup>48</sup> To find otherwise, asserts Canada, would be to hold governments responsible for the sourcing decisions of private commercial entities, and thereby base state-to-state obligations on "ephemeral conditions" outside government control.<sup>49</sup> The level and proportion of trade in motor vehicles from particular foreign sources resulting from the measure, in the view of Canada, is irrelevant for the purposes of Article I:1.<sup>50</sup>

67. The Panel's conclusion that the measure is inconsistent with Article I:1 of the GATT 1994 was based on two main elements. First, the Panel noted that Article I:1 applies to *de facto* discrimination, and can include measures that limit the benefit of the import duty exemption to certain importers only.<sup>51</sup> Second, the Panel recognized, as a finding of fact, the "predominantly, if not exclusively, 'intra-firm' character" of trade in automotive products in Canada.<sup>52</sup> The Panel then reasoned that:

...in a context of intra-firm trade, the limitation of the availability of the import duty exemption to certain manufacturers, including fully-owned subsidiaries of firms based in a very limited number of third countries, discriminates as to the origin of products which will benefit from the import duty exemption.<sup>53</sup>

The Panel concluded that this discrimination is inconsistent with Article I:1 of the GATT 1994.<sup>54</sup>

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<sup>47</sup>Canada's appellant's submission, para. 23.

<sup>48</sup>*Ibid.*, para. 27.

<sup>49</sup>*Ibid.*, paras. 38 and 51.

<sup>50</sup>*Ibid.*, paras. 31-32.

<sup>51</sup>Panel Report, paras. 10.38 and 10.40.

<sup>52</sup>*Ibid.*, para. 10.42.

<sup>53</sup>*Ibid.*, para. 10.45.

<sup>54</sup>*Ibid.*, para. 10.50.

68. In support of this finding, the Panel examined the total number and proportions of motor vehicles imported into Canada from various countries, and deduced that these statistics did "not warrant a conclusion that the import duty exemption is accorded on equal terms to like products of different origin."<sup>55</sup> The Panel also examined the historical context of the measure. The Panel found that the import duty exemption:

...stems from a bilateral agreement between Canada and the United States designed to resolve a long-standing trade dispute between Canada and the United States over trade in automotive products. This agreement was designed *inter alia* to achieve rationalization of production in the North-American market. From the perspective of Canada this involved the granting of import duty exemptions as an encouragement to US owned motor vehicle manufacturers to expand their production operations in Canada. We therefore consider that at the outset the import duty exemption was expected to benefit mainly imports from particular sources.<sup>56</sup>

69. On appeal, the issue before us is whether the import duty exemption accorded by this measure is consistent with Canada's obligations under Article I:1 of the GATT 1994. We are confronted with the daunting task of interpreting certain aspects of the "most-favoured-nation" ("MFN") principle that has long been a cornerstone of the GATT and is one of the pillars of the WTO trading system.

70. In examining the measure in issue, we note that the import duty exemption is afforded by Canada to imports of some, but not all, motor vehicles. We observe, first of all, that the Canadian Customs Tariff provides that a motor vehicle normally enters Canada at an MFN tariff rate of 6.1 per cent.<sup>57</sup> This is also the bound *ad valorem* rate in Canada's WTO Schedule of Concessions.<sup>58</sup> The MVTO 1998 and the SROs modify this rate by providing the import duty exemption for motor vehicles imported by certain manufacturers meeting certain ratio requirements and CVA requirements.<sup>59</sup> The MVTO 1998 accords the import duty exemption in the form of a "reduced rate of customs duty", established in the amended Canadian Customs Tariff as "free".<sup>60</sup> The SROs accord the import duty exemption in the form of a full duty "remission".<sup>61</sup>

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<sup>55</sup>Panel Report, para. 10.48.

<sup>56</sup>*Ibid.*, para. 10.49.

<sup>57</sup>*Supra*, footnote 19.

<sup>58</sup>Schedule V of Canada, Chapter 87, *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*, done at Marrakesh, 15 April 1994.

<sup>59</sup>The operation of the import duty exemption is explained in paras. 7-14 of this Report.

<sup>60</sup>MVTO 1998, Parts 1 and 2.

<sup>61</sup>See, e.g., CAMI Automotive Inc. Remission Order, SI/89-26, para. 3.

71. Although the measure on its face imposes no formal restriction on the *origin* of the imported motor vehicle, the Panel found that, in practice, major automotive firms in Canada import only their own make of motor vehicle and those of related companies.<sup>62</sup> Thus, according to the Panel,

...General Motors in Canada imports only GM motor vehicles and those of its affiliates; Ford in Canada imports only Ford motor vehicles and those of its affiliates; the same is true of Chrysler and of Volvo. These four companies all have qualified as beneficiaries of the import duty exemption. In contrast, other motor vehicle companies in Canada, such as Toyota, Nissan, Honda, Mazda, Subaru, Hyundai, Volkswagen and BMW, all of which also import motor vehicles only from related companies, do not benefit from the import duty exemption.<sup>63</sup>

72. Therefore, the Panel considered that, in practice, a motor vehicle imported into Canada is granted the "advantage" of the import duty exemption only if it originates in one of a small number of countries in which an exporter of motor vehicles is affiliated with a manufacturer/importer in Canada that has been designated as eligible to import motor vehicles duty-free under the MVTO 1998 or under an SRO.

73. Since 1989, no manufacturer not already benefiting from the import duty exemption on motor vehicles has been able to qualify under the MVTO 1998<sup>64</sup> or under an SRO. The list of manufacturers eligible for the import duty exemption was closed by Canada in 1989 in fulfilment of Canada's obligations under the CUSFTA.<sup>65</sup>

74. Thus, in sum, while the Canadian Customs Tariff normally allows a motor vehicle to enter Canada at the MFN duty rate of 6.1 per cent, the same motor vehicle has the "advantage" of entering Canada duty-free when imported by a designated manufacturer under the MVTO 1998 or under the SROs.<sup>66</sup>

75. In determining whether this measure is consistent with Article I:1 of the GATT 1994, we begin our analysis, as always, by examining the words of the treaty. Article I:1 states, in pertinent part:

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<sup>62</sup>Panel Report, para. 10.43.

<sup>63</sup>*Ibid.*

<sup>64</sup>MVTO 1998, Schedule, Part 1, para. 3.

<sup>65</sup>*Supra*, footnote 17 and para. 14.

<sup>66</sup>Assuming, as above, that that country benefits from Canada's MFN rate.

With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation...*any* advantage, favour, privilege or immunity granted by any Member to *any* product originating in or destined for any other country shall be accorded *immediately and unconditionally* to the *like product* originating in or destined for the territories of *all other Members*. (emphasis added)

76. The applicability of certain elements of Article I:1 is not in dispute in this case. First, the parties do not dispute that the import duty exemption is an "advantage, favour, privilege or immunity granted by any Member to any product".<sup>67</sup> Second, it is not disputed that some, but not all, motor vehicles imported from certain Members are accorded the import duty exemption, while some, but not all, like motor vehicles imported from certain other Members are not.<sup>68</sup> Third, the Panel's interpretation that the term "unconditionally" refers to advantages conditioned on the "situation or conduct" of exporting countries has not been appealed.<sup>69</sup>

77. One main issue remains in dispute: has the import duty exemption, accorded by the measure to motor vehicles originating in some countries, in which affiliates of certain designated manufacturers under the measure are present, also been accorded to like motor vehicles from all other Members, in accordance with Article I:1 of the GATT 1994?

78. In approaching this question, we observe first that the words of Article I:1 do not restrict its scope only to cases in which the failure to accord an "advantage" to like products of all other Members appears *on the face* of the measure, or can be demonstrated on the basis of the words of the measure. Neither the words "*de jure*" nor "*de facto*" appear in Article I:1. Nevertheless, we observe that Article I:1 does not cover only "in law", or *de jure*, discrimination. As several GATT panel reports confirmed, Article I:1 covers also "in fact", or *de facto*, discrimination.<sup>70</sup> Like the Panel, we

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<sup>67</sup>Panel Report, para. 10.16.

<sup>68</sup>*Ibid.*, paras. 10.32-10.33 and 10.36.

<sup>69</sup>*Ibid.*, para. 10.23.

<sup>70</sup>We note, though, that the measures examined in those reports differed from the measure in this case. Two of those reports dealt with "like" product issues: panel report, *Spain – Tariff Treatment of Unroasted Coffee*, L/5135, adopted 11 June 1981, BISD 28S/102; panel report, *Canada/Japan – Tariff on Imports of Spruce, Pine, Fir (SPF) Dimension Lumber*, L/6470, adopted 19 July 1989, BISD 36S/167. In this case, as we have noted, there is no dispute that the motor vehicles subject to the import duty exemption are "like" products. Furthermore, two other reports dealt with measures which, on their face, discriminated on a strict "origin" basis, so that, at any given time, either *every* product, or *no* product, of a particular origin was accorded an advantage. See panel report, *Belgian Family Allowances*, G/32, adopted 7 November 1952, BISD 1S/59; panel report, *European Economic Community – Imports of Beef from Canada*, L/5099, adopted 10 March 1981, BISD 28S/92. In this case, motor vehicles imported into Canada are not disadvantaged in that same sense.

cannot accept Canada's argument that Article I:1 does not apply to measures which, on their face, are "origin-neutral".<sup>71</sup>

79. We note next that Article I:1 requires that "*any advantage, favour, privilege or immunity granted by any Member to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other Members.*" (emphasis added) The words of Article I:1 refer not to *some* advantages granted "with respect to" the subjects that fall within the defined scope of the Article, but to "*any advantage*"; not to *some* products, but to "*any product*"; and not to like products from *some* other Members, but to like products originating in or destined for "*all other*" Members.

80. We note also the Panel's conclusion that, in practice, a motor vehicle imported into Canada is granted the "advantage" of the import duty exemption only if it originates in one of a small number of countries in which an exporter of motor vehicles is affiliated with a manufacturer/importer in Canada that has been designated as eligible to import motor vehicles duty-free under the MVTO 1998 or under an SRO.

81. Thus, from both the text of the measure and the Panel's conclusions about the practical operation of the measure, it is apparent to us that "[w]ith respect to customs duties...imposed on or in connection with importation..." Canada has granted an "advantage" to some products from some Members that Canada has not "accorded immediately and unconditionally" to "like" products "originating in or destined for the territories of *all other Members.*" (emphasis added) And this, we conclude, is not consistent with Canada's obligations under Article I:1 of the GATT 1994.

82. The context of Article I:1 within the GATT 1994 supports this conclusion. Apart from Article I:1, several "MFN-type" clauses dealing with varied matters are contained in the GATT 1994.<sup>72</sup> The very existence of these other clauses demonstrates the pervasive character of the MFN principle of non-discrimination.

83. The drafters also wrote various exceptions to the MFN principle into the GATT 1947 which remain in the GATT 1994.<sup>73</sup> Canada invoked one such exception before the Panel, relating to

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<sup>71</sup>Panel Report, para. 10.40.

<sup>72</sup>These relate to such matters as internal mixing requirements (Article III:7); cinema films (Article IV(b)); transit of goods (Article V:2, 5, 6); marks of origin (Article IX:1); quantitative restrictions (Article XIII:1); measures to assist economic development (Article XVIII:20); and measures for goods in short supply (Article XX(j)).

<sup>73</sup>Such as in Articles XX (general exceptions), XXI (security exceptions) and XXIV (customs unions and free trade areas).

customs unions and free trade areas under Article XXIV. This justification was rejected by the Panel, and the Panel's findings on Article XXIV were not appealed by Canada. Canada has invoked no other provision of the GATT 1994, or of any other covered agreement, that would justify the inconsistency of the import duty exemption with Article I:1 of the GATT 1994.

84. The object and purpose of Article I:1 supports our interpretation. That object and purpose is to prohibit discrimination among like products originating in or destined for different countries. The prohibition of discrimination in Article I:1 also serves as an incentive for concessions, negotiated reciprocally, to be extended to all other Members on an MFN basis.

85. The measure maintained by Canada accords the import duty exemption to certain motor vehicles entering Canada from certain countries. These privileged motor vehicles are imported by a limited number of designated manufacturers who are required to meet certain performance conditions. In practice, this measure does not accord the same import duty exemption immediately and unconditionally to like motor vehicles of *all* other Members, as required under Article I:1 of the GATT 1994. The advantage of the import duty exemption is accorded to some motor vehicles originating in certain countries without being accorded to like motor vehicles from *all* other Members. Accordingly, we find that this measure is not consistent with Canada's obligations under Article I:1 of the GATT 1994.

86. We, therefore, uphold the Panel's conclusion that Canada acts inconsistently with Article I:1 of the GATT 1994 by according the advantage of the import duty exemption to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members.

## **VI. Article 3.1(a) of the *SCM Agreement***

### **A. *Whether the Measure Constitutes a "Subsidy"***

87. Canada appeals the Panel's finding that the measure is a "subsidy" within the meaning of Article 1.1 of the *SCM Agreement*.<sup>74</sup> For Canada, the measure does not, in the language of Article 1.1, forego "government revenue that is otherwise due".<sup>75</sup> Canada argues that the import duty exemption at issue here cannot be equated mechanically with a tax exemption, such as the one at issue

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<sup>74</sup>Canada's appellant's submission, para. 57.

<sup>75</sup>*Ibid.*, para. 60.

in *United States – Tax Treatment for "Foreign Sales Corporations"* ("*United States – FSC*").<sup>76</sup> For Canada, the import duty exemption should be considered a "subsidy" only if it provides an exemption from duties *in excess* of those that would have "accrued".<sup>77</sup> Canada maintains, as well, that most motor vehicles benefiting from the import duty exemption could have been imported into Canada duty-free under the NAFTA.<sup>78</sup>

88. The Panel found that the measure results, within the terms of Article 1.1 of the *SCM Agreement*, in "government revenue" foregone that is "otherwise due", and therefore constitutes a "financial contribution".<sup>79</sup> For the Panel, Canada's argument that "if an import duty exemption were necessarily treated as revenue foregone, a subsidy would exist every time generalised preferences or duty drawbacks were granted by a WTO Member"<sup>80</sup> is inapposite. The Panel stated that "these examples advanced by Canada involve factual and legal considerations distinct from those in the case at hand".<sup>81</sup> In addition, the Panel found that a "benefit" is conferred by this "financial contribution".<sup>82</sup> The Panel therefore concluded that there is a "subsidy" within the meaning of Article 1.1.

89. In considering this conclusion on appeal, we look first at the wording of Article 1.1 of the *SCM Agreement*, which states, *inter alia*, that a "subsidy" exists if "there is a financial contribution by a government... and a benefit is thereby conferred". A "financial contribution" is deemed to exist, *inter alia*, where "government revenue that is *otherwise due* is foregone or not collected".<sup>83</sup> (emphasis added)

90. It is not in dispute that import duties are "government revenue", and that the import duty exemption afforded by this measure confers a "benefit" upon its recipients under Article 1.1(b) of the *SCM Agreement*. What is in dispute is whether "government revenue that is *otherwise due is foregone*" in the sense of Article 1.1(a)(1)(ii) of the *SCM Agreement*. In *United States – FSC*, we said the following about the United States tax measure at issue there:

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<sup>76</sup>Appellate Body Report, WT/DS108/AB/R, adopted 20 March 2000; Canada's appellant's submission, para. 69.

<sup>77</sup>Canada's appellant's submission, para. 72.

<sup>78</sup>*Ibid.*, para. 73.

<sup>79</sup>Panel Report, para. 10.163.

<sup>80</sup>*Ibid.*, para. 10.162.

<sup>81</sup>*Ibid.*

<sup>82</sup>*Ibid.*, para. 10.165.

<sup>83</sup>Article 1.1(a)(1)(ii) of the *SCM Agreement*.



In our view, the "*foregoing*" of revenue "*otherwise due*" implies that less revenue has been raised by the government than would have been raised in a different situation, or, that is, "*otherwise*". Moreover, the word "*foregone*" suggests that the government has given up an entitlement to raise revenue that it could "*otherwise*" have raised. This cannot, however, be an entitlement in the abstract, because governments, in theory, could tax *all* revenues. There must, therefore, be some defined, normative benchmark against which a comparison can be made between the revenue actually raised and the revenue that would have been raised "*otherwise*". We, therefore, agree with the Panel that the term "*otherwise due*" implies some kind of comparison between the revenues due under the contested measure and revenues that would be due in some other situation. We also agree with the Panel that the basis of comparison must be the tax rules applied by the Member in question. ... What is "*otherwise due*", therefore, depends on the rules of taxation that each Member, by its own choice, establishes for itself.<sup>84</sup>

91. The principles stated in that case also apply here. We note, once more, that Canada has established a normal MFN duty rate for imports of motor vehicles of 6.1 per cent.<sup>85</sup> Absent the import duty exemption, this duty would be paid on imports of motor vehicles. Thus, through the measure in dispute, the Government of Canada has, in the words of *United States – FSC*, "given up an entitlement to raise revenue that it could 'otherwise' have raised."<sup>86</sup> More specifically, through the import duty exemption, Canada has ignored the "defined, normative benchmark" that it established for itself for import duties on motor vehicles under its normal MFN rate and, in so doing, has foregone "government revenue that is otherwise due".

92. Canada argues that the measure is "analogous" to the situation described in footnote 1 to the *SCM Agreement*, which provides that "the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy." We do not share Canada's view. Footnote 1 to the *SCM Agreement* deals with duty and tax exemptions or remissions for *exported* products. The measure at issue applies, in contrast, to *imports* of motor vehicles which are sold for consumption in Canada. For this reason, we do not consider that footnote 1 bears upon the import duty exemption at issue in this case.

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<sup>84</sup>*Supra*, footnote 76, para. 90.

<sup>85</sup>*Supra*, footnote 19.

<sup>86</sup>*Supra*, footnote 76, para. 90.

93. In our view, it is also not relevant that motor vehicles benefiting from the import duty exemption may enter Canada duty-free if imported under the provisions of the NAFTA. Duty-free treatment under the NAFTA is not at issue in this case. The measure at issue in this case is the import duty exemption set out in the MVTO 1998 and the SROs.

94. For these reasons, we uphold the Panel's finding that "government revenue that is otherwise due is foregone" and that the measure constitutes a "subsidy" under Article 1.1 of the *SCM Agreement*.<sup>87</sup>

B. *Whether the Measure is "Contingent...in Law...upon Export Performance"*

95. Canada appeals the Panel's finding that the measure is a subsidy which is "contingent ...in law...upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*. Canada argues that the Panel erred in law by misinterpreting the definition of "contingent", and alleges that the Panel did not "even attempt to demonstrate contingency 'on the basis of the words of the relevant legislation...'; instead, it resorted to hypothetical 'facts'."<sup>88</sup> Thus, Canada maintains that the Panel erroneously found the measure contingent "in law" upon export performance because it conducted a "hypothetical" analysis of certain factual elements.<sup>89</sup> Canada submits, furthermore, that the facts relating to the measure do not demonstrate that it is *de facto* contingent upon export performance.<sup>90</sup>

96. The Panel concluded that the subsidy provided by the measure is "contingent...in law...upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*.<sup>91</sup> In its analysis, the Panel examined the ratio requirements, but not the CVA requirements<sup>92</sup>, of the measure under the MVTO 1998 and the SROs. The Panel found that "the MVTO 1998 and the SROs demonstrate, on their face, that the import duty exemption is contingent upon export performance...".<sup>93</sup>

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<sup>87</sup>Panel Report, para. 10.170.

<sup>88</sup>Canada's appellant's submission, para. 77.

<sup>89</sup>*Ibid.*, para. 78.

<sup>90</sup>*Ibid.*, para. 80.

<sup>91</sup>Panel Report, para. 10.201.

<sup>92</sup>The Panel's failure to examine the European Communities' claim relating to the CVA requirements under Article 3.1(a) of the *SCM Agreement* is dealt with in Section VII of this Report.

<sup>93</sup>Panel Report, para. 10.192.

97. Article 3.1 of the *SCM Agreement* provides, in pertinent part:

Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;

...

(footnotes omitted)

98. In *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*"), we noted that the key word in Article 3.1(a) is "contingent":

...the ordinary connotation of "contingent" is "conditional" or "dependent for its existence on something else". This common understanding of the word "contingent" is borne out by the text of Article 3.1(a), which makes an explicit link between "contingency" and "conditionality" in stating that export contingency can be the sole or "one of several other *conditions*".<sup>94</sup> (footnote omitted)

99. Although in *Canada – Aircraft* we were dealing with a subsidy that was contingent "in fact" upon export performance, we stated in that case that "the legal standard expressed by the word 'contingent' is the same for both *de jure* or *de facto* contingency."<sup>95</sup> We stated, furthermore, that:

There is a difference, however, in what evidence may be employed to prove that a subsidy is export contingent. *De jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument. Proving *de facto* export contingency is a much more difficult task. There is no single legal document which will demonstrate, on its face, that a subsidy is "contingent...in fact...upon export performance". Instead, the existence of this relationship of contingency, between the subsidy and export performance, must be *inferred* from the total configuration of the facts constituting and surrounding the granting of the subsidy, none of which on its own is likely to be decisive in any given case.<sup>96</sup>

(emphasis in italics in the original; emphasis in underlining added)

100. We start with what we have held previously. In our view, a subsidy is contingent "in law" upon export performance when the existence of that condition can be demonstrated on the basis of the very words of the relevant legislation, regulation or other legal instrument constituting the measure.

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<sup>94</sup>Appellate Body Report, WT/DS70/AB/R, adopted 20 August 1999, para. 166.

<sup>95</sup>*Ibid.*, para. 167.

<sup>96</sup>*Ibid.*

The simplest, and hence, perhaps, the uncommon, case is one in which the condition of exportation is set out expressly, in so many words, on the face of the law, regulation or other legal instrument. We believe, however, that a subsidy is also properly held to be *de jure* export contingent where the condition to export is clearly, though implicitly, in the instrument comprising the measure. Thus, for a subsidy to be *de jure* export contingent, the underlying legal instrument does not always have to provide *expressis verbis* that the subsidy is available only upon fulfillment of the condition of export performance. Such conditionality can also be derived by necessary implication from the words actually used in the measure.

101. In this case, the key legal instrument setting out the ratio requirements is the MVTO 1998. The Panel found that, for the four MVTO automobile manufacturer beneficiaries, the MVTO 1998 is the *only* legal instrument setting out the ratio requirements.<sup>97</sup> For the manufacturers that are beneficiaries under the SROs, each SRO specifies a precise ratio requirement for the company for which it is issued.<sup>98</sup>

102. The Panel found, as a matter of fact, that:

...the ratio requirements applicable to the MVTO 1998 beneficiaries are, "as a general rule", 95:100 for automobiles, at least 75:100 for SCVs and at least 75:100 for buses. With respect, specifically, to the four automobile manufacturer beneficiaries under the MVTO 1998, Canada has stated, in response to a question from the Panel, that the amounts of the ratio requirements are confidential. Canada adds that they range from the low-80s:100 to the high-90s:100, and the average of the four amounts is approximately 95:100. We further note that the SROs issued prior to 1997 set the minimum ratio requirement at 75:100. Regarding the SROs issued since 1997, almost all such SROs have the ratio requirement set at 100:100.<sup>99</sup> (footnotes omitted)

103. As the MVTO 1998 is the key legal instrument setting out the ratio requirements, compliance with which enables a manufacturer to qualify for the import duty exemption, it is important to quote the relevant aspects of the definition of "manufacturer" in that regulation:

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<sup>97</sup>Panel Report, para. 10.193.

<sup>98</sup>*Ibid.*, para. 10.182.

<sup>99</sup>*Ibid.* We note that the Panel referred to "1997" rather than "1977" in para. 10.182 of the Panel Report. We believe this reference is simply a clerical error, as confirmed by the Panel's reference to "1977" in para. 2.34 of its Report.

"[M]anufacturer" means a manufacturer of a class of vehicles who

...

(b) produced vehicles of a class in Canada in the 12-month period ending on July 31 in which the importation is made where

(i) the ratio of the net sales value of the vehicles produced to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in that period is equal to or higher than the ratio of the net sales value of all vehicles of that class produced in Canada by the manufacturer in the base year to the net sales value of all vehicles of that class sold for consumption in Canada by the manufacturer in the base year, and is not in any case lower than 75 to 100...<sup>100</sup>

104. We agree with the Panel that "[i]n cases where the production-to-sales ratio is 100:100, the only way to import any motor vehicles duty-free is to export, and the amount of import duty exemption allowed is directly dependent upon the amount of exports achieved."<sup>101</sup> Like the Panel, we fail to see how a manufacturer with a production-to-sales ratio of 100:100 could obtain access to the import duty exemption – and still maintain its required production-to-sales ratio – without exporting. A manufacturer producing motor vehicles in Canada with a sales value of 100 that does not export must sell all those motor vehicles in Canada. That manufacturer's production-to-sales ratio becomes 100:100, but without the benefit of importing duty-free one single motor vehicle. Only if that manufacturer exports motor vehicles produced in Canada does it become entitled to import motor vehicles free of duty. The value of motor vehicles which can be imported duty-free is strictly limited to the value of motor vehicles exported. In our view, as the import duty exemption is simply not available to a manufacturer unless it exports motor vehicles, the import duty exemption is clearly conditional, or dependent upon, exportation and, therefore, is contrary to Article 3.1(a) of the SCM Agreement.

105. Where the ratio requirements are set at less than 100:100 (for example, we know that the four MVTO automobile manufacturer beneficiaries have, on average, ratio requirements of approximately 95:100)<sup>102</sup>, the relationship between exports and the ability to import duty-free is less straightforward. With a ratio requirement of 95:100, a manufacturer producing motor vehicles in Canada with a sales value of 95 that does not export is nevertheless entitled to import, duty-free, additional motor vehicles with a sales value of 5. If that manufacturer doubles its Canadian production to 190, then the amount of the duty-free "allowance" also doubles, to 10; that is, the

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<sup>100</sup>MVTO 1998, Schedule, Part 1, para. 1(1), definition of "manufacturer".

<sup>101</sup>Panel Report, para. 10.184.

<sup>102</sup>*Ibid.*, para. 10.182.

"allowance" increases in direct proportion to the increase in production. The Panel considered that, up to this amount, the import duty exemption is not contingent upon export performance.<sup>103</sup> However, should a manufacturer wish to import on a duty-free basis any motor vehicles above its "allowance", that manufacturer must export motor vehicles. As in the case of a 100:100 ratio requirement, for a manufacturer with a ratio requirement less than 100:100, for any amount above this duty-free "allowance", the value of vehicles which can be imported duty-free is strictly limited, and tied to, the value of vehicles exported. The Panel found that for the amount exceeding the duty-free "allowance" there is, therefore, a clear relationship of contingency between the import duty exemption and export performance.<sup>104</sup>

106. We share the Panel's view. Regardless of the actual ratio specified for a particular manufacturer, the MVTO 1998 and the SROs operate, as a matter of law, in such a manner that the more motor vehicles a manufacturer exports, the more motor vehicles that manufacturer is entitled to import duty-free.

107. Although we are not examining whether the subsidy in this case is contingent "in fact" upon export performance, we note that footnote 4 to Article 3.1(a) uses the words "tied to" as a synonym for "contingent" or "conditional". As the legal standard is the same for *de facto* and *de jure* export contingency<sup>105</sup>, we believe that a "tie", amounting to the relationship of contingency, between the granting of the subsidy and actual or anticipated exportation meets the legal standard of "contingent" in Article 3.1(a) of the *SCM Agreement*.

108. Even where the ratio requirement for a particular manufacturer is set at less than 100:100, in our view, there is contingency "in law" upon export performance because, as a result of the operation of the MVTO 1998 and the SROs themselves, the granting of, or the entitlement to, the import duty exemption is tied to the exportation of motor vehicles by the manufacturer beneficiaries. By the very operation of the measure, the more motor vehicles that a manufacturer exports, the more motor vehicles it can import duty-free. In other words, a clear relationship of dependency or conditionality exists between the granting of the import duty exemption and the exportation of motor vehicles by manufacturer beneficiaries. We find, therefore, that, even when the ratio requirements are less than 100:100, the measure is "contingent...in law...upon export performance".

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<sup>103</sup>Panel Report, para. 10.188.

<sup>104</sup>*Ibid.*, para. 10.191.

<sup>105</sup>Appellate Body Report, *Canada – Aircraft*, *supra*, footnote 94, para. 167.

109. For these reasons, we uphold the Panel's conclusion that the measure is a "subsidy" as that term is used in Article 1 of the *SCM Agreement* which is "contingent...in law...upon export performance" within the meaning of Article 3.1(a) of the same Agreement. Accordingly, we also uphold the Panel's finding that Canada acts inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement*.<sup>106</sup>

#### **VII. Article 3.1(a) of the *SCM Agreement* - European Communities' Claim Regarding CVA Requirements**

110. The European Communities argues that the Panel failed to examine the claim of the European Communities that the CVA requirements constitute a subsidy contingent upon export performance in contravention of Article 3.1(a) of the *SCM Agreement*, and that this failure constitutes a legal error.<sup>107</sup> Although the European Communities does not specify the precise legal error it is alleging, and does not refer to any provision in the *WTO Agreement* that has been infringed, it would appear that the European Communities is alleging that the Panel did not act in accordance with Article 11 of the DSU, in particular, in applying the principle of judicial economy.

111. An examination of the Panel Report reveals that the Panel made no mention in its findings of the European Communities' *alternative* claim that the CVA requirements condition of the measure is inconsistent with Article 3.1(a) of the *SCM Agreement*.<sup>108</sup> To all appearances, the Panel simply overlooked this *alternative* claim. Instead, the Panel dealt with several related claims of the European Communities. The Panel found that the CVA requirements are inconsistent with Article III:4 of the GATT 1994<sup>109</sup> and Article XVII of the GATS<sup>110</sup>, but are consistent with Article 3.1(b) of the *SCM Agreement*.<sup>111</sup> The Panel also found that the measure is a prohibited export subsidy under Article 3.1(a) of the *SCM Agreement* because of the condition of the ratio requirements.<sup>112</sup>

112. In assessing this allegation of legal error made by the European Communities, we refer to the obligations of panels set out in very general terms in Article 11 of the DSU. This provision reads, in relevant part:

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<sup>106</sup>Panel Report, para. 10.201.

<sup>107</sup>European Communities' appellant's submission, paras. 62-64.

<sup>108</sup>*Ibid.*, para. 64.

<sup>109</sup>Panel Report, para. 10.90.

<sup>110</sup>*Ibid.*, para. 10.308.

<sup>111</sup>*Ibid.*, paras. 10.216 and 10.222.

<sup>112</sup>*Ibid.*, para. 10.201.

...a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and *make such other findings as will assist the DSB* in making the recommendations or in giving the rulings provided for in the covered agreements. (emphasis added)

113. The standard terms of reference of a panel, set out in Article 7.1 of the DSU, speak in very similar terms. A panel should make "such findings as will assist the DSB" in making recommendations or rulings. Under Article 7.2 of the DSU, a panel "shall address the relevant provisions in any covered agreement or agreements cited by the parties to the dispute."

114. In discharging its functions under Articles 7 and 11 of the DSU, a panel is not, however, required to examine *all* legal claims made before it. A panel may exercise judicial economy. In *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, we said:

Nothing in [Article 11 of the DSU] or in previous GATT practice requires a panel to examine all legal claims made by the complaining party. Previous GATT 1947 and WTO panels have frequently addressed only those issues that such panels considered necessary for the resolution of the matter between the parties, and have declined to decide other issues. Thus, if a panel found that a measure was inconsistent with a particular provision of the GATT 1947, it generally did not go on to examine whether the measure was also inconsistent with other GATT provisions that a complaining party may have argued were violated.<sup>113</sup>

115. We refined this notion in *Australia – Measures Affecting the Importation of Salmon* ("*Australia – Salmon*"), where we said:

The principle of judicial economy has to be applied keeping in mind the aim of the dispute settlement system. This aim is to resolve the matter at issue and "to secure a positive solution to a dispute". To provide only a partial resolution of the matter at issue would be false judicial economy. *A panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member* with those recommendations and rulings "in order to ensure effective resolution of disputes to the benefit of all Members."<sup>114</sup> (emphasis added; footnote omitted)

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<sup>113</sup>Appellate Body Report, WT/DS33/AB/R, adopted 23 May 1997, p. 18.

<sup>114</sup>Appellate Body Report, WT/DS18/AB/R, adopted 6 November 1998, para. 223.



116. In our view, it was not necessary for the Panel to make a determination on the European Communities' *alternative* claim relating to the CVA requirements under Article 3.1(a) of the *SCM Agreement* in order "to secure a positive solution" to this dispute. The Panel had already found that the CVA requirements violated both Article III:4 of the GATT 1994 and Article XVII of the GATS. Having made these findings, the Panel, in our view, exercising the discretion implicit in the principle of judicial economy, could properly decide not to examine the *alternative* claim of the European Communities that the CVA requirements are inconsistent with Article 3.1(a) of the *SCM Agreement*.

117. We are bound to add that, for purposes of transparency and fairness to the parties, a panel should, however, in all cases, address expressly those claims which it declines to examine and rule upon for reasons of judicial economy. Silence does not suffice for these purposes.

#### **VIII. Article 3.1(b) of the *SCM Agreement***

118. The European Communities and Japan appeal the Panel's finding that they failed to demonstrate that the import duty exemption is a subsidy which is "contingent...upon the use of domestic over imported goods" under Article 3.1(b) of the *SCM Agreement*. They maintain that the Panel erred in concluding that the measure is not contingent "in law" upon the use of domestic over imported goods.<sup>115</sup> In the alternative, the European Communities and Japan claim that the Panel erred in concluding that Article 3.1(b) does not extend to contingency "in fact", and they assert that the import duty exemption is contingent "in fact" upon the use of domestic over imported goods.<sup>116</sup> We address each of these issues in turn.

##### **A. *Whether the Measure is Contingent "in Law" Upon the Use of Domestic over Imported Goods***

119. In appealing the Panel's conclusion regarding contingency "in law", the European Communities argues that Article 3.1(b) of the *SCM Agreement* prohibits subsidies contingent upon a condition that "gives preference to" the use of domestic over imported goods.<sup>117</sup> On the other hand, Japan submits that Article 3.1(b) prohibits subsidies where the use of domestic over imported goods "would lead to" the granting or maintaining of the subsidy.<sup>118</sup> In their view, the Panel's interpretation is incompatible with the object and purpose of Article 3.1(b), and would allow circumvention of this

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<sup>115</sup>European Communities' appellant's submission, para. 5; Japan's appellant's submission, para. 2.

<sup>116</sup>*Ibid.*

<sup>117</sup>European Communities' appellant's submission, para. 23.

<sup>118</sup>Japan's appellant's submission, para. 7.

provision.<sup>119</sup> Furthermore, the European Communities and Japan argue that, applying the test used by the Panel, the CVA requirements, in certain circumstances, do require the "actual use of domestic goods"<sup>120</sup> as a matter of law.<sup>121</sup> Finally, according to the European Communities and Japan, the use of domestic over imported goods as a result of the CVA requirements is an "alternative" condition "in law" for receiving the import duty exemption, and is, therefore, inconsistent with Article 3.1(b) of the *SCM Agreement*.<sup>122</sup>

120. In examining the CVA requirements under Article 3.1(b), the Panel stated:

As we noted in the section of our report relating to claims under Article 3.1(a) of the *SCM Agreement*, the word "contingent" has been defined, *inter alia*, as "conditional, dependent". It is in light of this ordinary meaning of the word "contingent" that we must examine whether, under the CVA requirements outlined above, access to the import duty exemption is conditional or dependent upon the use of domestic over imported goods.<sup>123</sup>

121. The Panel found that:

...while under the MVTO 1998 and SROs access to the import duty exemption is contingent upon satisfying certain CVA requirements, a value-added requirement is in no sense synonymous with a condition to use domestic over imported goods. In this regard, we recall that the definition of "CVA" in the MVTO 1998 includes, in addition to parts and materials of Canadian origin, such other elements as direct labour costs, manufacturing overheads, general and administrative expenses and depreciation. Thus, and depending upon the factual circumstances, a manufacturer might well be willing and able to satisfy a CVA requirement without using any domestic goods whatsoever. *Under these circumstances, it would be difficult for us to conclude that access to the import duty exemption is contingent, i.e. conditional or dependent, in law on the use of domestic over imported goods within the meaning of the SCM Agreement.*<sup>124</sup> (emphasis added)

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<sup>119</sup>European Communities' appellant's submission, para. 25; Japan's appellant's submission, paras. 8 and 14.

<sup>120</sup>European Communities' appellant's submission, para. 28.

<sup>121</sup>See Japan's appellant's submission, para. 11.

<sup>122</sup>European Communities' appellant's submission, paras. 43-50; Japan's appellant's submission, paras. 9 and 17.

<sup>123</sup>Panel Report, para. 10.213.

<sup>124</sup>*Ibid.*, para. 10.216.

122. Article 3.1(b) provides as follows:

Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

...

- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.

As we have already found that the import duty exemption constitutes a "subsidy" within the meaning of Article 1 of the *SCM Agreement*, we turn to whether this subsidy is contingent "in law" upon the use of domestic over imported goods.

123. In our discussion of Article 3.1(a) in Section VI of this Report, we recalled that in *Canada – Aircraft* we stated that "the ordinary connotation of 'contingent' is 'conditional' or 'dependent for its existence on something else'."<sup>125</sup> Thus, a subsidy is prohibited under Article 3.1(a) if it is "conditional" upon export performance, that is, if it is "dependent for its existence on" export performance. In addition, in *Canada – Aircraft*, we stated that contingency "in law" is demonstrated "on the basis of the *words* of the relevant legislation, regulation or other legal instrument."<sup>126</sup> (emphasis added) As we have already explained, such conditionality can be derived by necessary implication from the words actually used in the measure.<sup>127</sup> We believe that this legal standard applies not only to "contingency" under Article 3.1(a), but also to "contingency" under Article 3.1(b) of the *SCM Agreement*.

124. As we are considering a claim of "in law" contingency under Article 3.1(b), it is important to quote the definition of "Canadian value added" set out in the key legal instrument, the MVTO 1998:

"Canadian value added" means

- (a) in relation to a class of vehicles produced in Canada in any 12-month period ending on July 31, *the aggregate of the following costs* to the manufacturer of producing all vehicles of that class that are produced in Canada by the manufacturer in that period and the following depreciation and capital cost allowances for that period, *namely*,

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<sup>125</sup>*Supra*, footnote 94, para. 166.

<sup>126</sup>*Ibid.*, para. 167.

<sup>127</sup>*Supra*, para. 100.

- (i) *the cost of parts produced in Canada, and the cost of materials to the extent that they are of Canadian origin*, that are incorporated in vehicles in the factory of the manufacturer in Canada, but not including parts produced in Canada, or materials to the extent that they are of Canadian origin, that have been exported from Canada and subsequently imported into Canada as parts or materials,
- (ii) transportation costs, including insurance charges,...
- (iii) notwithstanding subparagraph (i), the cost of the iron, steel and aluminum content of parts produced outside Canada for incorporation in the vehicles, if the iron, steel or aluminum was poured in Canada,...
- (iv) the part of the following costs that is reasonably attributable to the production of the vehicles, namely,
  - (A) wages paid for direct production labour in Canada,
  - (B) wages paid for indirect production and non-production labour in Canada,
  - (C) the cost of materials used in the production operation but not incorporated in the final product,
  - (D) the cost of heating, lighting, power and water,
  - (E) worker's compensation, employment insurance and group insurance premiums, pension contributions and similar expenses incurred in respect of labour referred to in clauses (A) and (B),
  - (F) taxes on land and buildings in Canada,
  - (G) fire and other insurance premiums,...
  - (H) rent for factory premises paid to the beneficial owner in Canada,
  - (I) the cost of maintenance and repair work executed in Canada on buildings, machinery and equipment used for production purposes,
  - (J) the cost of tools, dies, jigs, fixtures and other similar equipment of a non-permanent nature that have been manufactured in Canada,
  - (K) the cost of engineering services, experimental work and product development work executed in Canada, and
  - (L) miscellaneous factory expenses,
- (v) administrative and general expenses incurred in Canada that are reasonably attributable to the production of the vehicles,
- (vi) depreciation..., *and*
- (vii) a capital cost allowance...<sup>128</sup> (emphasis added)

This definition also applies to the SROs.

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<sup>128</sup>MVTO 1998, Schedule, Part 1, para. 1(1), definition of "Canadian value added".

125. The import duty exemption at issue in this appeal is contingent on the satisfaction of three requirements: (1) manufacturing presence in Canada, (2) the ratio requirements, and (3) the CVA requirements. The Panel found that each of these requirements was a "condition" for receiving the import duty exemption.<sup>129</sup> Under the measure, a manufacturer applying for the import duty exemption in a particular period is required to disclose to the Government of Canada the *aggregate* of the costs, listed in the definition of "Canadian value added" in the MVTO 1998, of producing vehicles in Canada, so as to demonstrate that the manufacturer has satisfied the CVA requirements. One of these costs – indeed, the first one listed – is Canadian parts and materials incorporated in motor vehicles in the factory of the manufacturer in Canada, that is, "domestic goods".

126. The precise issue under Article 3.1(b) is whether the *use* of domestic over imported goods is a "condition" for satisfying the CVA requirements, and, therefore, for receiving the import duty exemption.

127. In examining this issue, the Panel first set out the CVA requirements, as contained in three separate legal instruments: the MVTO 1998, the SROs, and the Letters of Undertaking.<sup>130</sup> With respect to the MVTO 1998, the Panel did not make any specific findings regarding the actual percentages of CVA required for individual manufacturer beneficiaries. The Panel simply noted that "there are the CVA requirements under the MVTO 1998 itself".<sup>131</sup> For the SROs, the Panel discussed "typical" levels of CVA required for companies operating under SROs issued before 1984 and those issued from 1984 onwards. For one manufacturer, CAMI Automotive Inc. ("CAMI"), the Panel stated that it "must meet a requirement that the total CVA of its vehicles and original equipment manufacturing parts produced in Canada in a given year must be at least 60 per cent of the cost of sales of vehicles sold in Canada in the same year."<sup>132</sup> With regard to the Letters of Undertaking signed by General Motors, Ford, Chrysler and American Motors, the Panel noted that these Letters require an *increase* in the amount of CVA by an amount equal to 60 per cent of the growth in their market for automobiles sold for consumption in Canada and by an amount equal to 50 per cent of the growth in their market for commercial vehicles sold for consumption in Canada, and include a requirement to achieve a stipulated increase in the annual CVA by the end of model year 1968. However, the Panel did *not* determine what the *actual* amount of CVA required is under those Letters.<sup>133</sup> The Panel added, in a footnote, that "[c]ompliance with [the Letters] is not explicitly a

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<sup>129</sup>Panel Report, para. 10.4.

<sup>130</sup>*Ibid.*, paras. 10.203-10.206.

<sup>131</sup>*Ibid.*, para. 10.204.

<sup>132</sup>*Ibid.*, para. 10.205.

<sup>133</sup>*Ibid.*, para. 10.206.

factor in determining the eligibility for the import duty exemption."<sup>134</sup> Apparently, the Panel found that the CVA requirements in the Letters are not "conditions" additional to those in the MVTO 1998 for the MVTO manufacturers.

128. The Panel then examined whether the import duty exemption is contingent "in law" upon the use of domestic over imported goods. In its examination, however, the Panel did not conduct an analysis of how the CVA requirements under the MVTO 1998 and the SROs actually work. The Panel began its legal analysis by stating that "a value-added requirement is in no sense synonymous with a condition to use domestic over imported goods."<sup>135</sup> The Panel apparently reached this conclusion without any inquiry into the specific CVA requirements for specific manufacturer beneficiaries. Although the Panel did explain what *types* of costs could be used to satisfy the CVA requirements, the Panel did not, for any MVTO manufacturer or for particular SRO manufacturers (with the exception of CAMI), make any findings as to the *actual level* of CVA required. The Panel's statement that "value-added requirements" are "not synonymous" with a condition to use domestic over imported goods seems to have been based on "value-added requirements" considered *in the abstract* as opposed to the actual CVA requirements for the MVTO and SRO manufacturer beneficiaries.

129. The Panel then recalled the following:

...we recall that the definition of "CVA" in the MVTO 1998 includes, in addition to parts and materials of Canadian origin, such other elements as direct labour costs, manufacturing overheads, general and administrative expenses and depreciation. *Thus, and depending upon the factual circumstances, a manufacturer might well be willing and able to satisfy a CVA requirement without using any domestic goods whatsoever.*<sup>136</sup> (emphasis added)

Once again, the Panel reached its conclusion here without examining the specific CVA requirements in the MVTO 1998 and the SROs. The Panel simply speculated that "depending upon the factual circumstances", a manufacturer *'might well be willing and able* to satisfy a CVA requirement *without using any domestic goods whatsoever*". (emphasis added) The Panel did not, however, scrutinize the actual CVA requirements for MVTO and SRO manufacturers to see whether they could indeed be satisfied without using domestic goods.

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<sup>134</sup>Panel Report, footnote 896.

<sup>135</sup>*Ibid.*, para. 10.216.

<sup>136</sup>*Ibid.*

130. The Panel's reasoning implies that under no circumstances could *any* value-added requirement result in a finding of contingency "in law" upon the use of domestic over imported goods. We do not agree. We noted that the definition of "Canadian value added" in the MVTO 1998 *requires* a manufacturer to report to the Government of Canada the *aggregate* of certain listed costs of its production of motor vehicles, and that the first such cost item specified is the cost of Canadian parts and materials *used* in the production of motor vehicles in its factory in Canada.<sup>137</sup> It seems to us that whether or not a particular manufacturer is able to satisfy its specific CVA requirements without using any Canadian parts and materials in its production depends very much on the *level* of the applicable CVA requirements. For example, if the level of the CVA requirements is very high, we can see that the use of domestic goods may well be a necessity and thus be, in practice, required as a *condition* for eligibility for the import duty exemption. By contrast, if the level of the CVA requirements is very low, it would be much easier to satisfy those requirements *without* actually using domestic goods; for example, where the CVA requirements are set at 40 per cent, it might be possible to satisfy that level simply with the aggregate of other elements of Canadian value added, in particular, labour costs. The multiplicity of *possibilities* for compliance with the CVA requirements, when these requirements are set at low levels, may, depending on the specific level applicable to a particular manufacturer, make the use of domestic goods only one *possible* means (means which might not, in fact, be utilized) of satisfying the CVA requirements.

131. In our view, the Panel's examination of the CVA requirements for specific manufacturers was insufficient for a reasoned determination of whether contingency "in law" on the use of domestic over imported goods exists. For the MVTO 1998 manufacturers and most SRO manufacturers, the Panel did not make findings as to what the actual CVA requirements are and how they operate for individual manufacturers. Without this vital information, we do not believe the Panel knew enough about the measure to determine whether the CVA requirements were contingent "in law" upon the use of domestic over imported goods. We recall that the Panel did make a finding as to the level of the CVA requirements for one company, CAMI. The Panel stated that the CVA requirements for CAMI are 60 per cent of the cost of sales of vehicles sold in Canada.<sup>138</sup> At this level, it may well be that the CVA requirements operate as a condition for using domestic over imported goods. However, the Panel did *not* examine how the CVA requirements would actually operate at a level of 60 per cent.

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<sup>137</sup>*Supra*, para. 125.

<sup>138</sup>Panel Report, para. 10.205.

132. The Panel's failure to examine fully the legal instruments at issue here and their implications for individual manufacturers vitiates its conclusion that the CVA requirements do not make the import duty exemption contingent "in law" upon the use of domestic over imported goods. In the absence of an examination of the operation of the applicable CVA requirements for individual manufacturers, the Panel simply did not have a sufficient basis for its finding on the issue of "in law" contingency. Thus, we conclude that the Panel erred in conducting its "in law" contingency analysis.

133. In *Australia – Salmon*, we stated that where we have reversed a finding of a panel, we should attempt to complete a panel's legal analysis "to the extent possible on the basis of the factual findings of the Panel and/or of undisputed facts in the Panel record".<sup>139</sup> Here, as we have stated, the Panel did not identify the precise levels of the CVA requirements applicable to specific manufacturers. In addition, there are not sufficient undisputed facts in the Panel record that would enable us to examine this issue ourselves. As a result, it is impossible for us to assess whether the use of domestic over imported goods is a condition "in law" for satisfying the CVA requirements, and, therefore, is a condition for receiving the import duty exemption.

134. In light of these considerations, we are unable to complete the legal analysis necessary to determine whether the import duty exemption, through the application of the CVA requirements, is contingent "in law" upon the use of domestic over imported goods. Therefore, we make no finding and reserve our judgment on whether the import duty exemption at issue is contingent "in law" upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.

B. *Whether the Measure is Contingent "in Fact" Upon the Use of Domestic over Imported Goods*

135. On appeal, the European Communities and Japan have maintained that if we find that the measure is not contingent "in law" upon the use of domestic over imported goods, then they appeal, in the alternative, the Panel's finding that Article 3.1(b) of the *SCM Agreement* does not apply to subsidies contingent "in fact" upon the use of domestic over imported goods.<sup>140</sup> The European Communities and Japan contend that Article 3.1(b) applies to subsidies contingent "in fact" upon the

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<sup>139</sup>*Supra*, footnote 114, para. 118.

<sup>140</sup>European Communities' appellant's submission, paras. 53-54; Japan's appellant's submission, para. 19.



use of domestic over imported goods<sup>141</sup>, and argue that the import duty exemption is precisely such a prohibited subsidy.<sup>142</sup>

136. The Panel examined the issue of whether Article 3.1(b) extends to subsidies contingent "in fact" upon the use of domestic over imported goods, and found as follows:

...we recall that Article 3.1 is, as clearly indicated by its chapeau, the provision that sets out the subsidies prohibited under the SCM Agreement. Paragraphs (a) and (b) are both part of Article 3.1 and manifestly similar. It is hard to imagine how the inclusion of the words "in law or in fact" in paragraph (a) and the absence of such words in paragraph (b) could be but a reflection of the intention of the drafters. We further recall that the Appellate Body has held in *Japan – Alcoholic Beverages* that "omission must have some meaning". That two provisions so alike and juxtaposed together should differ from each other in such specific respect signals, in our view, that the omission of the words "in law or in fact" from Article 3.1(b) was deliberate and that *Article 3.1(b) extends only to contingency in law*.<sup>143</sup> (emphasis added; footnote omitted)

137. In examining this issue, the Panel appears to have taken the view that the terms of Article 3.1(b), on their own, do not answer the question, and, therefore, it turned to the context provided by Article 3.1(a). In this respect, the Panel relied on the fact that, in Article 3.1(a), there is explicit language applying to subsidies contingent "in law or in fact" while in Article 3.1(b) there is not. In the view of the Panel, the absence of such an explicit reference in the adjacent and closely-related provision of Article 3.1(b) indicates that the drafters intended Article 3.1(b) to apply only to those subsidies which are contingent "in law" upon the use of domestic over imported goods.

138. In our view, the Panel's analysis was incomplete. As we have said, and as the Panel recalled, "omission must have some meaning."<sup>144</sup> Yet omissions in different contexts may have different meanings, and omission, in and of itself, is not necessarily dispositive. Moreover, while the Panel rightly looked to Article 3.1(a) as relevant context in interpreting Article 3.1(b), the Panel failed to examine other contextual elements for Article 3.1(b) and to consider the object and purpose of the *SCM Agreement*.

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<sup>141</sup>European Communities' appellant's submission, paras. 55-61; Japan's appellant's submission, paras. 20-33.

<sup>142</sup>European Communities' appellant's submission, para. 53; Japan's appellant's submission, paras. 36-51.

<sup>143</sup>Panel Report, para. 10.221.

<sup>144</sup>Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 18.

139. We look first to the text of Article 3.1(b). In doing so, we observe that the ordinary meaning of the phrase "contingent...upon the use of domestic over imported goods" is not conclusive as to whether Article 3.1(b) covers both subsidies contingent "in law" and subsidies contingent "in fact" upon the use of domestic over imported goods. Just as there is nothing in the language of Article 3.1(b) that specifically *includes* subsidies contingent "in fact", so, too, is there nothing in that language that specifically *excludes* subsidies contingent "in fact" from the scope of coverage of this provision. As the text of the provision is not conclusive on this point, we must turn to additional means of interpretation. Accordingly, we look for guidance to the relevant context of the provision.

140. Although we agree with the Panel that Article 3.1(a) is relevant context, we believe that other contextual aspects should also be examined. First, we note that Article III:4 of the GATT 1994 also addresses measures that favour the use of domestic over imported goods, albeit with different legal terms and with a different scope. Nevertheless, both Article III:4 of the GATT 1994 and Article 3.1(b) of the *SCM Agreement* apply to measures that require the use of domestic goods over imports. Article III:4 of the GATT 1994 covers both *de jure* and *de facto* inconsistency.<sup>145</sup> Thus, it would be most surprising if a similar provision in the *SCM Agreement* applied only to situations involving *de jure* inconsistency.

141. Second, we recall our findings in *European Communities – Regime for the Importation, Sale and Distribution of Bananas* ("*European Communities – Bananas*") on whether or not Article II of the GATS covers cases of *de facto* discrimination.<sup>146</sup> In that case, the Panel found that Article XVII of the GATS provides relevant context for determining whether Article II of the GATS applies to both *de jure* and *de facto* discrimination. On this issue, we said:

Article XVII of the GATS is merely one of many provisions in the *WTO Agreement* that require the obligation of providing "treatment no less favourable". The possibility that the two Articles may not have exactly the same meaning does *not* imply that the intention of the drafters of the GATS was that a *de jure*, or formal, standard should apply in Article II of the GATS. If that were the intention, why does Article II not say as much? The obligation imposed by Article II is unqualified. The ordinary meaning of this provision does not exclude *de facto* discrimination.<sup>147</sup>

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<sup>145</sup>See, e.g., panel report, *Italian Discrimination against Imported Agricultural Machinery*, L/833, BISD 7S/60, adopted 23 October 1958, para. 12.

<sup>146</sup>Appellate Body Report, WT/DS27/AB/R, adopted 25 September 1997, para. 233.

<sup>147</sup>*Ibid.*

We believe the same reasoning is applicable here. The fact that Article 3.1(a) refers to "in law or in fact", while those words are absent from Article 3.1(b), does not necessarily mean that Article 3.1(b) extends only to *de jure* contingency.

142. Finally, we believe that a finding that Article 3.1(b) extends only to contingency "in law" upon the use of domestic over imported goods would be contrary to the object and purpose of the *SCM Agreement* because it would make circumvention of obligations by Members too easy. We expressed a similar concern with respect to the GATS in *European Communities – Bananas* when we said:

Moreover, if Article II was not applicable to *de facto* discrimination, it would not be difficult -- and, indeed, it would be a good deal easier in the case of trade in services, than in the case of trade in goods -- to devise discriminatory measures aimed at circumventing the basic purpose of that Article.<sup>148</sup>

143. For all these reasons, we believe that the Panel erred in finding that Article 3.1(b) does not extend to subsidies contingent "in fact" upon the use of domestic over imported goods. We, therefore, reverse the Panel's broad conclusion that "Article 3.1(b) extends only to contingency in law."<sup>149</sup>

144. Having reached this conclusion, we must now consider whether the import duty exemption, as a result of the application of the CVA requirements, constitutes a subsidy contingent "in fact" upon the use of domestic over imported goods. We recall once more our statement in *Australia – Salmon* that, where we have reversed a finding of a panel, we should attempt to complete a panel's legal analysis "to the extent possible on the basis of the factual findings of the Panel and/or of undisputed facts in the Panel record".<sup>150</sup>

145. We stated earlier that the Panel's incomplete analysis of the operation of the CVA requirements leaves us with an insufficient basis on which to examine how the CVA requirements function. Furthermore, as the Panel concluded that Article 3.1(b) did not extend to contingency "in fact", the Panel did not examine the claims of the European Communities and Japan on this issue. As a result the Panel made *no* factual findings relating to the operation of the CVA requirements. In addition, there are not sufficient undisputed facts in the Panel record that would enable us to examine this issue ourselves. It is impossible for us to assess whether the use of domestic over imported goods

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<sup>148</sup>*Supra*, footnote 146, para. 233.

<sup>149</sup>Panel Report, para. 10.221.

<sup>150</sup>*Supra*, footnote 114, para. 118.

is "in fact" a condition for satisfying the CVA requirements, and, therefore, is a condition for receiving the import duty exemption.

146. We are thus unable to complete the legal analysis necessary to determine whether the import duty exemption, through the application of the CVA requirements, is contingent "in fact" upon the use of domestic over imported goods. Accordingly, we make no finding and reserve our judgment on whether the import duty exemption at issue is contingent "in fact" upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.

#### **IX. Article I:1 and Article II:1 of the GATS**

147. Canada appeals the Panel's conclusion that the import duty exemption is inconsistent with Article II:1 of the GATS. Canada first appeals the Panel's finding that the measure is one "affecting trade in services" within the scope of Article I:1 of the GATS.<sup>151</sup> It then appeals the finding that Canada does not accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country contrary to its obligations under Article II:1 of the GATS.<sup>152</sup>

##### *A. Article I:1 of the GATS*

148. Canada maintains that the Panel erred in finding that the import duty exemption falls within the scope of the GATS. In the view of Canada, the Panel mistakenly concluded that whether a measure is within the scope of the GATS is determined by whether that measure is consistent with certain substantive obligations, such as Article II, and not by whether the measure falls within Article I of the GATS.<sup>153</sup>

149. The Panel first examined the general issue of whether the import duty exemption constitutes a measure "affecting trade in services" within the meaning of Article I of the GATS. The Panel then referred to the reports of the panel and the Appellate Body in *European Communities – Bananas* for the proposition that "the term 'affecting' in Article I of the GATS has a broad scope of application and that accordingly no measures are *a priori* excluded from the scope of application of the GATS."<sup>154</sup>

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<sup>151</sup>Canada's appellant's submission, para. 102.

<sup>152</sup>*Ibid.*, para. 145.

<sup>153</sup>*Ibid.*, para. 102.

<sup>154</sup>Panel Report, para. 10.231.

150. The Panel ultimately found that:

[t]he determination of whether a measure affects trade in services cannot be done in abstract terms in isolation from examining whether the effect of such a measure is consistent with the Member's obligations and commitments under the GATS. In this case, the determination of whether the MVTO 1998 and SROs are measures affecting trade in services within the meaning of Article I of the GATS should be done on the basis of the determination of whether these measures constitute less favourable treatment for the services and service suppliers of some Members as compared to those of others (Article II) and/or for services and service suppliers of other Members as compared to domestic ones (Article XVII).<sup>155</sup>

151. In *United States – Import Prohibition of Certain Shrimp and Shrimp Products*, we said, in the context of Article XX of the GATT 1994, that a panel may not ignore the "fundamental structure and logic" of a provision in deciding the proper sequence of steps in its analysis, save at the peril of reaching flawed results.<sup>156</sup> Similarly, here, the fundamental structure and logic of Article I:1, in relation to the rest of the GATS, require that determination of whether a measure is, in fact, covered by the GATS must be made *before* the consistency of that measure with any substantive obligation of the GATS can be assessed.

152. Article II:1 of the GATS states expressly that it applies only to "any measure covered by this Agreement". This explicit reference to the scope of the GATS confirms that the measure at issue must be found to be a measure "affecting trade in services" within the meaning of Article I:1, and thus covered by the GATS, *before* any further examination of consistency with Article II can logically be made. We find, therefore, that the Panel should have inquired, as a threshold question, into whether the measure is within the scope of the GATS by examining whether the import duty exemption is a measure "affecting trade in services" within the meaning of Article I. In failing to do so, the Panel erred in its interpretative approach.

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<sup>155</sup>Panel Report, para. 10.234.

<sup>156</sup>Appellate Body Report, WT/DS58/AB/R, adopted 6 November 1998, para. 119. See also Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 22.

153. We proceed to the threshold analysis of Article I of the GATS. Article I:1 of the GATS states, in pertinent part:

*Article I*

*Scope and Definition*

1. This Agreement applies to measures by Members *affecting trade in services*.
2. For the purposes of this Agreement, *trade in services* is defined as *the supply of a service*:
  - (a) from the territory of one Member into the territory of any other Member;
  - (b) in the territory of one Member to the service consumer of any other Member;
  - (c) *by a service supplier of one Member, through commercial presence in the territory of any other Member*;
  - (d) by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member.  
(emphasis added)

154. Article XXVIII defines certain terms used in the GATS. We refer, in particular, to the following:

- (a) "measure" means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form;
- (b) "supply of a service" includes the production, distribution, marketing, sale and delivery of a service;
- (c) "measures by Members affecting trade in services" include measures in respect of
  - ...
  - (iii) the presence, including commercial presence, of persons of a Member for the supply of a service in the territory of another Member;
- (d) "commercial presence" means any type of business or professional establishment, including through
  - (i) the constitution, acquisition or maintenance of a juridical person,...
  - ...within the territory of a Member for the purpose of supplying a service;  
...

- (f) "service of another Member" means a service which is supplied,  
...  
(ii) in the case of the supply of a service through commercial presence or through the presence of natural persons, by a service supplier of that other Member;
- (g) "service supplier" means any person that supplies a service;  
...

155. With these treaty provisions in mind, we believe that at least two key legal issues must be examined to determine whether a measure is one "affecting trade in services": first, whether there is "trade in services" in the sense of Article I:2; and, second, whether the measure in issue "affects" such trade in services within the meaning of Article I:1.

156. We look first at whether there is "trade in services" in this case. For the purposes of the GATS, "trade in services" is defined in Article I:2 as the "supply of a service" in any one of four listed modes of supply. At issue here is the supply of a service under mode (c) of Article I:2, that is, the supply of a service "by a service supplier of one Member, through *commercial presence* in the territory of any other Member". (emphasis added) "Commercial presence" is, in turn, defined in Article XXVIII(d) as "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person...".

157. The complainants in this case allege that the "trade in services" here relevant is "wholesale trade services of motor vehicles", which is a category of services recognized in the Central Product Classification.<sup>157</sup> Canada does not dispute that there are service suppliers of the United States, the European Communities and Japan which are established in Canada and which provide wholesale trade services of motor vehicles.<sup>158</sup> Accordingly, we hold that the "trade in services" here in issue is wholesale trade services of motor vehicles supplied by service suppliers of certain Members through commercial presence in Canada.

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<sup>157</sup>Provisional Central Product Classification, United Nations Statistical Papers, Series M, No. 77, 1991, Subclass 61111, p. 189. This was replaced in 1997 by the Central Product Classification (CPC) Version 1.0 (United Nations Statistical Papers, Series M, No. 77, 1998, Subclass 61281, p. 363), which continues to recognize wholesale trade services of motor vehicles as a category of services.

<sup>158</sup>Panel Report, para. 10.237.

158. Having concluded that there is, in fact, "trade in services" in this case, we consider next whether the measure at issue "affects" trade in services. In *European Communities – Bananas*, we said:

In our view, the use of the term "affecting" reflects the intent of the drafters to give a broad reach to the GATS. The ordinary meaning of the word "affecting" implies a measure that has "an effect on", which indicates a broad scope of application. This interpretation is further reinforced by the conclusions of previous panels that the term "affecting" in the context of Article III of the GATT is wider in scope than such terms as "regulating" or "governing".<sup>159</sup>

159. We also found in that case that, although the subject matter of the GATT 1994 and that of the GATS are different, particular measures "could be found to fall within the scope of both the GATT 1994 and the GATS", and that such measures include those "that involve a service relating to a particular good or a service supplied in conjunction with a particular good."<sup>160</sup> We further stated, in that case, that:

Whether a certain measure affecting the supply of a service related to a particular good is scrutinized under the GATT 1994 or the GATS, or both, is a matter that can only be determined on a case-by-case basis.<sup>161</sup>

160. In cases where the same measure can be scrutinized under *both* the GATT 1994 and the GATS, however, the focus of the inquiry, and the specific aspects of the measure to be scrutinized, under each agreement, will be different because the subjects of the two agreements are different. Under the GATS, as we stated in *European Communities – Bananas*, "the focus is on how the measure affects the supply of the service or the service suppliers involved."<sup>162</sup>

161. We note that Canada argues that the import duty exemption is not a measure "affecting trade in services" within the meaning of Article I of the GATS, because it is a tariff measure that affects the *goods* themselves and not the supply of distribution services.<sup>163</sup> As such, Canada maintains, the measure at issue does not "affect" a service supplier in its *capacity as a service supplier* and in its *supply of a service*.<sup>164</sup> Canada relies on our report in *European Communities – Bananas* to support

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<sup>159</sup>*Supra*, footnote 146, para. 220.

<sup>160</sup>*Ibid.*, para. 221.

<sup>161</sup>*Ibid.*; see also Appellate Body Report, *Canada – Certain Measures Concerning Periodicals*, WT/DS31/AB/R, adopted 30 July 1997, p. 19.

<sup>162</sup>*Supra*, footnote 146, para. 221.

<sup>163</sup>Canada's appellant's submission, para. 115.

<sup>164</sup>*Ibid.*



its argument that the import duty exemption falls exclusively within the scope of the GATT 1994, as it affects trade in goods as goods, and does *not* involve a service *relating to a particular good* or a service *supplied in conjunction with a particular good*.<sup>165</sup>

162. The Panel, however, determined that:

Like the measures at issue in the *EC – Bananas III* case, the import duty exemption granted only to manufacturer beneficiaries bears upon conditions of competition in the supply of distribution services, regardless of whether it directly governs or indirectly affects the supply of such services. In our view, therefore, the import duty exemption falls in the third category of measures, identified by the Appellate Body in *EC – Bananas III*, as involving "a service relating to a particular good or a service supplied in conjunction with a particular good", which "could be scrutinized under both the GATT 1994 and the GATS".<sup>166</sup>

163. In *European Communities – Bananas*, we agreed with the panel that "the operators as defined under the relevant regulations of the European Communities are, indeed, suppliers of 'wholesale trade services' within the definition set out in the Headnote to Section 6 of the CPC."<sup>167</sup> Although the operators in that case were engaged in certain activities that were not, strictly speaking, within the definition of "distributive trade services" in the Headnote to Section 6 of the Central Product Classification, we concluded there that "there is no question that they are also engaged in other activities involving the wholesale distribution of bananas that are within that definition."<sup>168</sup> With respect to the fact that the operators were vertically integrated with producers, ripeners and retailers, we stated, in that case, that "even if a company is vertically-integrated, and even if it performs other functions related to the production, importation, distribution and processing of a product, *to the extent that it is also engaged in providing 'wholesale trade services'* and is therefore *affected in that capacity* by a particular measure of a Member *in its supply of those 'wholesale trade services'*, that company *is a service supplier* within the scope of the GATS."<sup>169</sup> (emphasis added)

164. In this case, the Panel did not examine any evidence relating to the provision of wholesale trade services of motor vehicles within the Canadian market and, as a result, did not make any factual findings as to the structure of the market for motor vehicles in Canada, nor as to which companies actually provide wholesale trade services of motor vehicles. As a result, the Panel also never

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<sup>165</sup>Canada's appellant's submission, para. 115.

<sup>166</sup>Panel Report, para. 10.239.

<sup>167</sup>*Supra*, footnote 146, para. 225.

<sup>168</sup>*Ibid.*

<sup>169</sup>*Ibid.*, para. 227.

examined whether or how the import duty exemption affects *wholesale trade service suppliers in their capacity as service suppliers*. Rather, the Panel simply stated:

Like the measures at issue in the *EC – Bananas III* case, the import duty exemption granted only to *manufacturer beneficiaries* bears upon conditions of competition in the supply of distribution services, regardless of whether it directly governs or indirectly affects the supply of such services.<sup>170</sup> (emphasis added)

165. We do not consider this statement of the Panel to be a sufficient basis for a legal finding that the import duty exemption "affects" wholesale trade services of motor vehicles *as services*, or wholesale trade service suppliers *in their capacity as service suppliers*. The Panel failed to analyze the evidence on the record relating to the provision of wholesale trade services of motor vehicles in the Canadian market. It also failed to articulate what it understood Article I:1 to require by the use of the term "affecting". Having interpreted Article I:1, the Panel should then have examined all the relevant facts, including *who* supplies wholesale trade services of motor vehicles through commercial presence in Canada, and *how* such services are supplied. It is not enough to make assumptions. Finally, the Panel should have applied its interpretation of "affecting trade in services" to the facts it should have found.

166. The European Communities and Japan may well be correct in their assertions that the availability of the import duty exemption to certain manufacturer beneficiaries of the United States established in Canada, and the corresponding unavailability of this exemption to manufacturer beneficiaries of Europe and of Japan established in Canada, has an effect on the operations in Canada of wholesale trade service suppliers of motor vehicles and, therefore, "affects" those wholesale trade service suppliers in their capacity as service suppliers. However, the Panel did not examine this issue. The Panel merely asserted its conclusion, without explaining how or why it came to its conclusion. This is not good enough.

167. For these reasons, we believe that the Panel has failed to examine whether the measure is one "affecting trade in services" as required under Article I:1 of the GATS. The Panel did not show that the measure at issue affects wholesale trade services of motor vehicles, as services, or wholesale trade service suppliers of motor vehicles, in their *capacity as service suppliers*. Nonetheless, we continue our analysis of the issues raised on appeal under Article II:1, and examine whether, in the terms of that provision, the measure accords treatment "no less favourable" to like services and service suppliers of other Members.

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<sup>170</sup>Panel Report, para. 10.239.

B. *Article II:1 of the GATS*

168. Canada argues that even if the GATS was held applicable to the measure at issue, the Panel is still in error in finding that this measure accords less favourable treatment to services and service suppliers of any other Member under Article II:1.<sup>171</sup> Canada states that neither the European Communities nor Japan contended that the import duty exemption discriminates "in law"; rather, they argue that the import duty exemption discriminates "in fact" by according less favourable treatment in practice to certain services and service suppliers.<sup>172</sup> In Canada's view, the Panel "was required to set out the basis on which the measures accord less favourable treatment to certain services and service suppliers and to show how such less favourable treatment is accorded, either in fact or in law, to the services or service suppliers of certain Members."<sup>173</sup>

169. In examining Canada's appeal under Article II:1 of the GATS, we begin with the text of that provision:

*Article II*

*Most-Favoured-Nation Treatment*

1. With respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.

170. The wording of this provision suggests that analysis of the consistency of a measure with Article II:1 should proceed in several steps. First, as we have seen, a threshold determination must be made under Article I:1 that the measure is covered by the GATS.<sup>174</sup> This determination requires that there be "trade in services" in one of the four modes of supply, and that there be also a measure which "affects" this trade in services. We have already held that the Panel failed to undertake this analysis.<sup>175</sup>

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<sup>171</sup>Canada's appellant's submission, para. 145.

<sup>172</sup>*Ibid.*, para. 146.

<sup>173</sup>*Ibid.*, para. 147.

<sup>174</sup>*Supra*, para. 152.

<sup>175</sup>*Supra*, para. 167.

171. If the threshold determination is that the measure *is* covered by the GATS, appraisal of the consistency of the measure with the requirements of Article II:1 is the next step. The text of Article II:1 requires, in essence, that treatment by one Member of "services and services suppliers" of any other Member be compared with treatment of "like" services and service suppliers of "any other country". Based on these core legal elements, the Panel should first have rendered its interpretation of Article II:1. It should then have made factual findings as to treatment of wholesale trade services and service suppliers of motor vehicles of different Members commercially present in Canada. Finally, the Panel should have applied its interpretation of Article II:1 to the facts as it found them.

172. The Panel did none of this. The Panel did not inquire into how the market for wholesale trade services of motor vehicles in Canada is structured. Nor did it explain how less favourable treatment resulted from the measure at issue. Instead, it engaged in speculation about the "possibility" of certain relationships.<sup>176</sup> In response to Canada's argument that there is no competition between service suppliers at the wholesale level because of vertical integration and exclusive distribution arrangements in the motor vehicle industry, the Panel stated that vertical integration:

...neither rules out potential competition in the wholesaler-manufacturer relationship, nor actual competition in the wholesaler-retailer relationship. Although due to the existing structure of the market, wholesale trade service suppliers procure their vehicles from the same manufacturers, no government measure prevents even a vertically integrated wholesale distributor from approaching different manufacturers for the procurement of motor vehicles.<sup>177</sup>

173. Based on this speculative analysis, the Panel proceeded to make the following "findings":

We therefore **find** that vertical integration and exclusive distribution arrangements between manufacturers and wholesalers in the motor vehicle industry *do not rule out the possibility* that treatment less favourable *may be granted* to suppliers of wholesale trade services for motor vehicles. We also **find** that vertical integration and exclusive distribution arrangements *do not preclude potential competition* among wholesalers for the procurement of vehicles from manufacturers and actual inter-brand competition for sales to retailers.<sup>178</sup> (emphasis in italics added)

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<sup>176</sup>Panel Report, paras. 10.253-10.254.

<sup>177</sup>*Ibid.*, para. 10.253.

<sup>178</sup>*Ibid.*, para. 10.254.

174. We consider these "findings" of the Panel to be pure speculation. As we stated above, the Panel did not provide an interpretation of Article II:1; nor did it apply its interpretation to findings of fact. The Panel did not identify any evidence defining the relationship between manufacturers and wholesale trade service suppliers of motor vehicles in the Canadian market. Furthermore, the Panel did not examine, *in concreto*, the structure of competition in the wholesale trade services market for motor vehicles in Canada. Its reasoning seems to be based solely on Canada's argument that the motor vehicle industry is characterized by vertical integration of production and distribution as well as exclusive distribution arrangements.<sup>179</sup> The Panel failed to conduct an analysis of whether and how the import duty exemption affects wholesalers related to manufacturers which benefit from the import duty exemption, as compared with wholesalers related to manufacturers which do not benefit from the import duty exemption. For these reasons, we reverse the Panel's "findings" in paragraph 10.254 of the Panel Report.

175. The Panel also considered two additional arguments of the complainants. The European Communities and Japan argued before the Panel that, although the criteria for eligibility for the import duty exemption are not expressly based on nationality, the import duty exemption constitutes *de facto* discrimination under Article II of the GATS as all, or almost all, service suppliers of other Members which benefit from the exemption are of the United States.<sup>180</sup> Canada disputed this point and argued that at least two manufacturer beneficiaries are of European Communities' origin (Volvo Canada Ltd. and DaimlerChrysler Canada Inc.). Canada also maintained, before the Panel, that CAMI is a 50/50 joint venture between juridical persons of Japan and of the United States. The European Communities and Japan alleged, before the Panel, that the import duty exemption also results in *de jure* discrimination under Article II, because, in their view, the existence of the closed list of manufacturer beneficiaries constitutes formally different treatment.<sup>181</sup>

176. After finding that DaimlerChrysler Canada Inc. and Volvo Canada Ltd. are both juridical persons of the United States, and deciding that there is no evidence which would allow it to determine which juridical person "controls" CAMI, the Panel stated:

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<sup>179</sup>Panel Report, para. 10.253.

<sup>180</sup>*Ibid.*, para. 10.255.

<sup>181</sup>*Ibid.*

Although none of the criteria for granting the import duty exemption is expressly based on nationality, the manufacturing presence requirement, referring to the period 1 August 1963 – 31 July 1964 in the MVTO 1998, has allowed only three service suppliers of the United States (Chrysler Canada Ltd., General Motors of Canada Ltd. and Ford Motor Company of Canada Ltd.) and one service supplier of Sweden (Volvo Canada Ltd.) to qualify for the import duty exemption. It was noted above that Volvo Canada Ltd. recently passed under the control of a juridical person of the United States (Ford Motor Co.). SROs have been used to expand the category of manufacturer beneficiaries by allowing two other manufacturers/wholesalers of automobiles (Intermeccanica of Canada and CAMI, a 50/50 joint venture between Suzuki Motor Co. of Japan and General Motors Corp. of the United States) and several manufacturers/wholesalers of buses and specified commercial vehicles to qualify for the import duty exemption.<sup>182</sup> (footnote omitted)

177. Having determined which manufacturer beneficiaries are "of " which Members, the Panel does not go on to explain the relevance of these findings to its analysis under Article II:1. In particular, the Panel does not clearly link these "manufacturer beneficiaries" to the suppliers of wholesale trade services of motor vehicles, which are the relevant entities under Article II:1.

178. The Panel concludes as follows:

In our view, the import duty exemption, as provided in the MVTO 1998 and SROs, results in less favourable treatment accorded to services and service suppliers of any other Member within the meaning of Article II:1 of the GATS, as such benefit is granted to a limited and identifiable group of manufacturers/wholesalers of motor vehicles of some Members, selected on the basis of criteria such as the manufacturing presence in a given base year. We also note that the manufacturing presence requirements in the MVTO 1998 and in the SROs explicitly exclude suppliers of wholesale trade services of motor vehicles, which do not manufacture vehicles in Canada, from qualifying for the import duty exemption. In addition, the fact that in 1989 the Government of Canada stopped granting SROs makes the list of the beneficiaries of the import duty exemption a closed one. As a result, manufacturers/wholesalers of motor vehicles of some Members can import vehicles into Canada duty-free, while manufacturers/wholesalers of other Members are explicitly prevented from importing vehicles duty free into Canada.<sup>183</sup>

179. The Panel ultimately found, on the basis of this reasoning, that "with respect to the import duty exemption, granted to a limited number of manufacturers/wholesalers of motor vehicles, Canada has failed to accord immediately and unconditionally to services and service suppliers of any other

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<sup>182</sup>Panel Report, para. 10.261.

<sup>183</sup>*Ibid.*, para. 10.262.

Member treatment no less favourable than it accords to like services and service suppliers of any other country."<sup>184</sup> On this basis, the Panel found that the import duty exemption is inconsistent with the requirements of Article II:1 of the GATS.<sup>185</sup>

180. Here, the Panel has compounded its earlier error in finding that the import duty exemption which benefits certain *manufacturers* of motor vehicles "is granted to a limited and identifiable group" of *manufacturer/wholesalers* of motor vehicles. The Panel appears to be saying here that the import duty exemption is granted to certain *wholesalers* of a limited number of Members, and not to *wholesalers* of other Members. Furthermore, the Panel states that, as a result of the closed list, *wholesalers* of motor vehicles of a limited number of Members can import vehicles into Canada duty-free, while *wholesalers* of other Members are explicitly prevented from importing vehicles duty-free into Canada.<sup>186</sup>

181. Clearly, here the Panel is confusing the *application* of the import duty exemption to *manufacturers* with its possible *effect* on *wholesalers*. In our view, the Panel has conducted a "goods" analysis of this measure, and has simply extrapolated its analysis of how the import duty exemption affects manufacturers to wholesale trade service suppliers of motor vehicles. The Panel surmised, without analyzing the effect of the measure on wholesalers *as service suppliers*, that the import duty exemption, granted to a limited number of manufacturers, *ipso facto* affects conditions of competition among wholesalers *in their capacity as service suppliers*. As we stated earlier in respect of whether the measure at issue "affects trade in services", the Panel failed to demonstrate how the import duty exemption granted to certain *manufacturers*, but not to other *manufacturers*, affects the supply of *wholesale trade services* and *the suppliers of wholesale trade services* of motor vehicles. In reaching its conclusions under Article II:1 of the GATS, the Panel has neither assessed the relevant facts – we see no analysis of any evidence relating to the supply of *wholesale trade services* of motor vehicles – nor has it interpreted Article II of the GATS and applied that interpretation to the facts it found.

182. For these reasons, we reverse the Panel's conclusion that the import duty exemption accorded pursuant to the MVTO 1998 and the SROs is inconsistent with the requirements of Article II:1 of the GATS<sup>187</sup>, and its findings leading to that conclusion.

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<sup>184</sup>Panel Report, para. 10.264.

<sup>185</sup>*Ibid.*

<sup>186</sup>*Ibid.*, para. 10.262.

<sup>187</sup>*Ibid.*, para. 10.264.

183. In coming to this conclusion, we do not suggest that the import duty exemption does *not* affect wholesale trade services of motor vehicles in Canada. Nor do we conclude that Canada accords no less favourable treatment to services and service suppliers of any Member than that which it accords to like services and service suppliers of another country consistently with Article II:1 of the GATS. We make no such conclusion. We mean only to say that the Panel, in this case, failed to substantiate its conclusion that the import duty exemption is inconsistent with Article II:1 of the GATS. As such, we have no choice but to reverse the findings and conclusions of the Panel relating to Article II:1 of the GATS.

184. In reaching this conclusion, we are mindful of the importance of the GATS as a new multilateral trade agreement covered by the *WTO Agreement*. This appeal is only the second case in which we have been asked to review a panel's findings on provisions of the GATS. Given the complexity of the subject-matter of trade in services, as well as the newness of the obligations under the GATS, we believe that claims made under the GATS deserve close attention and serious analysis. We leave interpretation of Article II of the GATS to another case and another day.

## **X. Findings and Conclusions**

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

- (a) upholds the Panel's conclusion that Canada acts inconsistently with Article I:1 of the GATT 1994 by granting the advantage of duty-free treatment to motor vehicles originating in certain countries, pursuant to the MVTO 1998 and the SROs, which advantage is not accorded immediately and unconditionally to like products originating in the territories of all other WTO Members;
- (b) upholds the Panel's conclusion that Canada acts inconsistently with its obligations under Article 3.1(a) of the *SCM Agreement* by granting a subsidy which is contingent in law upon export performance, as a result of the application of the ratio requirements as one of the conditions for determining eligibility for the import duty exemption on motor vehicles under the MVTO 1998 and the SROs;
- (c) finds that the Panel's failure to address the European Communities' alternative claim that the measure, as a result of the application of the CVA requirements as one of the conditions for the import duty exemption, is a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement*, was a proper exercise of judicial economy;



- (d) is unable to come to a conclusion, and hence reserves judgment, on whether or not the import duty exemption is, as a result of the application of the CVA requirements, contingent "in law" upon the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*; reverses the Panel's conclusion that Article 3.1(b) does not extend to contingency "in fact"; and is unable to come to a conclusion, and hence reserves judgment, on whether or not the measure is contingent "in fact" upon the use of domestic over imported goods under Article 3.1(b) of the *SCM Agreement*, as a result of insufficient factual findings and undisputed facts in the Panel record;
- (e) finds that the Panel has failed to examine whether the measure is one "affecting trade in services" as required under Article I:1 of the GATS; reverses the Panel's conclusion that the import duty exemption accorded pursuant to the MVTO 1998 and the SROs is inconsistent with the requirements of Article II:1 of the GATS; and also reverses the Panel's findings leading to its conclusion on Article II:1.

186. The Appellate Body recommends that the DSB request that Canada bring its measure found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with Canada's obligations under Articles I:1 and III:4 of the GATT 1994, Article XVII of the GATS and paragraph (a) of Article 3.1 of the *SCM Agreement* into conformity with its obligations in those agreements.

Signed in the original at Geneva this 18th day of May 2000 by:

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Claus-Dieter Ehlermann  
Presiding Member

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James Bacchus  
Member

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Florentino Feliciano  
Member