AUSTRALIA - SUBSIDIES PROVIDED TO PRODUCERS AND EXPORTERS OF AUTOMOTIVE LEATHER

Report of the Panel
WT/DS126/R

Adopted by the Dispute Settlement Body on 16 June 1999

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I. INTRODUCTION

1.1 On 4 May 1998, the United States requested consultations with Australia under Articles 1 and 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") and Articles 4.1 and 30 (to the extent that it incorporates by reference Article XXIII:1 of the General Agreement on Tariffs and Trade 1994) of the Agreement on Subsidies and Countervailing Measures (the "SCM Agreement") regarding allegedly prohibited subsidies provided to an Australian producer and exporter of automotive leather, Howe and Company Proprietary Ltd. ("Howe"), or any of its affiliated and/or parent companies (WT/DS126/1).

1.2 The United States and Australia met on 4 June 1998.[1]

1.3 On 11 June 1998, pursuant to Article 4.4 of the SCM Agreement and Article 1.2 of the DSU, the United States requested the immediate establishment of a panel to examine the consistency of the subsidies provided to Howe with Australia's obligations under the Marrakesh Agreement Establishing the World Trade Organization (the "WTO Agreement"), in particular those contained in the SCM Agreement (WT/DS126/2).

1.4 At the meeting of the Dispute Settlement Body ("DSB") on 22 June 1998, the DSB established a panel in accordance with Article 4.4 of the SCM Agreement and Article 6 of the DSU with standard terms of reference. The terms of reference were:

> To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document

[1] Australia does not consider that this meeting constituted "consultations" under the DSU. *See* WT/DS126/3, 19 June 1998.

> WT/DS126/2, the matter referred to the DSB by the United States in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements. (WT/DS126/4)

1.5 On 27 October 1998, the United States requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the DSU. On 2 November 1998, the Director-General composed the Panel as follows:

Chairperson: H. E. Carmen Luz Guarda
Members: Mr. Jean-François Bellis
Mr. Wieslaw Karsz

1.6 The Panel met with the parties on 9-10 December 1998 and 13-14 January 1999.

1.7 The Panel submitted its interim report to the parties on 8 March 1999. On 15 March 1999, Australia and the United States submitted written requests for the Panel to review precise aspects of the interim report. The Panel submitted its final report to the parties on 23 March 1999.

II. FACTUAL ASPECTS

2.1 This dispute concerns certain assistance provided by the government of Australia to Howe, a wholly-owned subsidiary of Australian Leather Upholstery Pty. Ltd., which is owned by Australian Leather Holdings, Limited ("ALH"), part of which is owned by Schaffer Corporation, Ltd. Howe is the only dedicated producer and exporter of automotive leather in Australia. Automotive leather is primarily used for seat coverings and other interior components of automobiles, such as head and armrests, centre consoles and door trim.

2.2 On 9 March 1997, the Australian government signed two contracts with ALH and Howe: a grant contract (the "grant contract") and a loan contract (the "loan contract") providing for funding for an assistance package. The Australian Department of State of Industry, Science and Resources[2] is the governmental authority responsible for administering the contracts and disbursing the payments thereunder.

2.3 The grant contract provides for a series of three grant payments totalling up to a maximum of A$30 million. The aggregate of payments under the grant contract was capped at A$30 million to limit the overall level of *ad valorem*

[2] Before October 1998, this Department was known as the Department of Industry, Science and Tourism.

subsidization of sales over the period to mid-2000 to approximately 5 percent.[3] The payments were scheduled to occur in three instalments: the first payment of A$5 million was to paid upon conclusion of the grant contract; the second payment of up to A$12.5 million was to be paid in July 1997 on the basis of Howe's performance against the performance targets set out in the grant contract for the period 1 April 1997 to 30 June 1997, as well as due diligence considerations such as whether the company was functioning properly; the third payment of up to A$12.5 million was to be paid in July 1998 on the basis of Howe's performance against the performance targets set out in the grant contract for the period 1 July 1997 to 30 June 1998, as well as due diligence considerations such as whether the company was functioning properly. The performance targets consisted of sales targets and capital expenditure targets for certain specified periods: 1 April - 30 June 1997; 1 July 1997 - 30 June 1998; 1 July 1998 - 30 June 1999; and 1 July 1999 - 30 June 2000. Under the grant contract, Howe was required to use its best endeavours to achieve the performance targets. With regard to capital expenditure under the grant contract, the aggregate target for approved capital expenditure was $22.8 million over the four-year period in question.[4] The maximum amount of A$30 million was essentially paid out in the three grant payments, in accordance with the grant contract.[5]

2.4 The loan contract provides for a fifteen-year loan of $A25 million by the government of Australia to ALH/Howe. For the first five-year period of this loan, ALH/Howe is not required to pay principal or interest. After the expiration of this five-year period, interest on the loan is to be based on the rate for Australian Commonwealth Bonds with a ten-year maturity, plus two percentage points. The loan is secured by a second lien over the assets and undertakings of ALH.

2.5 These arrangements were put in place by the Australian government in compensation[6] for the excision, as of 1 April 1997, of automotive leather from the Australian Textiles, Clothing and Footwear Import Credit Scheme[7] (the

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[3] *See* para. 123 of Australia's first written submission; *infra*, para 7.191.

[4] Howe constructed a new tannery at Rosedale and a new finishing plant at Thomastown. The latter was commissioned during February/March 1998 and commenced operating in April 1998. It replaced the old plant in Preston which was decommissioned during the same period and closed in May 1998.

[5] A portion of the third payment of A$12.5 million was held back pending completion of the audit process.

[6] In response to questioning by the Panel, Australia stated that this was not "compensation" in the sense of off-setting a legal obligation on the part of the government of Australia, nor in the sense of trying to achieve an equivalent outcome, nor in the sense of it being an equivalent amount of assistance. Australia stated, however, that there was a political commitment to help maintain the commercial viability of Howe in the light of the settlement reached between Australia and the United States in November 1996.

[7] The ICS has been in effect from 1 July 1991, and remains in effect through 30 June 2000. Under this programme, exporters of eligible textile, clothing and footwear products can earn import credits that may be used to reduce the import duties payable on eligible textile, clothing and foot-

"ICS") and the Export Facilitation Scheme for Automotive Products[8] (the "EFS") pursuant to a settlement agreement with the United States reached in November 1996. This excision was enacted on 26 March 1997 by Australian Customs Notice No. 97/29. Automotive leather will be part of the general textile, industry and clothing arrangements due to come into force in Australia on 1 July 2000.

III. PREVIOUS WTO DISPUTE SETTLEMENT PROCEDURES BETWEEN THE PARTIES WITH RESPECT TO THE SAME OR RELATED MATTERS

3.1 On 7 October 1996, the United States requested consultations with Australia concerning subsidies available to leather under the ICS and any other subsidies to leather granted or maintained in Australia which were prohibited under Article 3 of the SCM Agreement.[9] Following one round of consultations, the United States and Australia reached a settlement on 24 November 1996. This settlement was announced on 25 November 1996. Under the terms of settlement, the government of Australia would excise automotive leather from eligibility under the ICS, as well as under the EFS, by 1 April 1997. On 26 March 1997, Australian Customs Notice No. 97/29 excised automotive leather from the ICS and EFS, effective 1 April 1997.

3.2 On 10 November 1997, the United States requested consultations regarding "prohibited subsidies provided to Australian producers and exporters of automotive leather, including subsidies provided to Howe Leather" which the United States understood to "include the provision by the government of Australia of an $A25 million loan on preferential and non-commercial terms and

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wear items by an amount up to the value of the credits held. Exporters are not required to use their credits as offsets against import duties, but may transfer them to another holder in exchange for a cash payment. The value of import credits that can be earned is calculated as the F.O.B. value of an eligible export sale, multiplied by the Australian value-added content of the export sale. This total is multiplied by a specified "Export Phasing Rate". *TCF Import Credit Scheme: Administrative Arrangements* (March 1995), United States Exhibit 7. The ICS is managed by the Australian Customs Service on behalf of the Australian Textiles, Clothing and Footwear Authority.

[8] The EFS has been in its current form since 1991, and remains in effect until 31 December 2000. The EFS allows Australian manufacturers to earn A$1 of export credit for every dollar of eligible exports of covered automotive items. The value of exports eligible to earn exports credits is equal to the Australian value-added content of eligible exports, calculated as the F.O.B. sales price less the value of any imported components and raw materials. Export credits earned under this programme can be used to obtain rebates on the duties payable on eligible imports of automotive vehicles and automotive components or may be sold for cash to any importer of eligible goods who may similarly seek such rebates. The amount of import duty that can be rebated under this programme is determined by a tariff reduction schedule that varies depending on the year in which the export credit is used. Australian Department of Industry, Science &Technology, *Report on the State of the Automotive Industry 1994* (June 1995), United States Exhibit 13.

[9] WT/DS57/1, G/SCM/D7/1, 9 October 1996.

grants amounting potentially to another $A30 million."[10] Consultations held between the United States and Australia on 16 December 1997 failed to resolve the dispute. At its meeting of 22 January 1998, the DSB established a panel in accordance with Article 4.4 of the SCM Agreement and Article 6 of the DSU pursuant to the request made by the United States on 9 January 1998. That panel was never composed.

IV. PROCEDURES ADOPTED BY THE PANEL GOVERNING "BUSINESS CONFIDENTIAL INFORMATION"

4.1 Due to concern expressed by one of the parties concerning the submission to the Panel of sensitive business information, the Panel adopted "Procedures Governing Business Confidential Information" at its first meeting with the parties. Pursuant to these procedures, only "approved persons" - i.e. a Panel member, representative, Secretariat employee or a member of the Permanent Group of Experts (the "PGE") - having filed with the Chairperson of the Panel a Declaration of Non-Disclosure were permitted to view or hear information designated by a party as business confidential information in the course of the Panel proceedings. Such approved persons were under an obligation not to disclose that information, or allow it to be disclosed, to any other person other than another approved person, except in accordance with the Procedures. The Panel was under an obligation not to disclose business confidential information in its interim and final reports, but could make statements of conclusion drawn from such information. Accordingly, the Panel has taken steps to ensure that all information designated by a party as business confidential information has been omitted from this Panel Report. Where the Panel deemed it necessary, a description of the type of information concerned has been provided.

V. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

5.1 The **United States** asks the Panel to make the following preliminary requests and rulings:

(a) that Australia produce, by 30 November 1998, authentic copies of certain documents[11] for review by the Panel and the United States;

(b) "rejecting Australia's argument that any further proceedings before this Panel should be terminated";

[10] WT/DS106/1, G/SCM/D17/1, 17 November 1997.
[11] These documents are listed *infra*, para. 6.1.

(c) "that the United States has met its obligations under Article 4.2 of the Subsidies Agreement"; and

(d) "rejecting Australia's argument that the Panel should disregard those facts and argument not explicitly set forth in the consultation request".

5.2 With respect to the merits of the case, the United States requests the Panel to find that "Australia is in violation of its obligations under Article 3.1 of the SCM Agreement", and asks the Panel to "recommend that Australia withdraw the subsidy to Howe without delay".

5.3 **Australia** asks the Panel to make the following preliminary rulings:

(a) that "the establishment of the Panel was inconsistent with the DSU and that as a consequence the Panel should terminate its work";

(b) that "in WT/DS126/1 the United States did not meet its disclosure obligations under Article 4 of the Subsidies Agreement and that consequently the establishment of the Panel and the basis for the United States case before the Panel are irremediably flawed. Australia asks that, as a consequence, the Panel terminate the proceedings, or rule immediately that the United States has not demonstrated its claims before the Panel"; and

(c) "If the Panel does not agree to the requests in subparagraphs [(a) and (b)] above, then Australia asks that the Panel rule that, as a result of the failure of the United States to fulfil its disclosure obligations under Article 4 of the Subsidies Agreement, all facts and arguments not explicitly spelled out in the request for the Panel (WT/DS126/1) will be disregarded for the purpose of the proceedings of the Panel. Of this evidence, Australia asks in addition that information acquired in the context of consultations under WT/DS106/1 be ruled to be confidential to that process [footnote omitted] and not admissible before this Panel, including Exhibit 2 of the United States First Submission."

5.4 In the event that the Panel does not terminate the proceedings on the basis of Australia's requests for preliminary rulings, Australia requests the Panel to find that:

(a) "the Loan does not fall under Article 3.1(a) of the Subsidies Agreement";

(b) "the two first payments under the Grant contract do not fall under Article 3.1(a) of the Subsidies Agreement"; or

(c) "if the Panel decides to consider subsequent payments or the Grant contract itself, none of the payments or the Grant contract itself falls under Article 3.1(a) of the Subsidies Agreement".

5.5 In addition, if the Panel finds that any measure before it is inconsistent with Article 3.1(a) of the SCM Agreement, then Australia requests that:

(a) "consistent with Article 19.2 of the DSU, the Panel make no recommendation or suggestion regarding the way in which Australia should bring itself into conformity"; and

(b) "consistent with Article 4.12 of the Subsidies Agreement, recommend that Australia have at least 7.5 months for implementation from the adoption of the Panel or Appellate Body report, i.e. at least half of that provided as a benchmark period in Article 21.3(c) of the DSU, but that this issue be addressed by the Panel and the parties after the circulation of the Interim Report setting out the Panel's draft findings on the nature of the measures before the Panel".

VI. PRELIMINARY ISSUES AND REQUESTS FOR PRELIMINARY RULINGS

A. Request for Documents by the United States

6.1 In its first written submission to the Panel, the **United States** asked the Panel to request that Australia produce, by 30 November 1998, authentic copies of the following documents for review by the Panel and the United States:

(a) "Any document which provides the grant from the Australian government to Howe, and any related documents;

(b) The loan contract between the Australian government and Howe, and any documents related to that contract;

(c) The report prepared by the accounting firm commissioned by the Australian government and used in devising the replacement package;

(d) Financial statements of Howe (or related corporate entities) for the period 1989 to present;

(e) Internal business plans or strategic plans of Howe (or related corporate entities) for the period 1995 to present;

(f) Any correspondence between the Australian government and Howe (or corporate entities related to Howe), or vice versa, regarding the replacement subsidy package;

(g) Annual reports of Howe (or related corporate entities) for the period 1989 to present; and

(h) Any analysis or forecast of the Australian automotive leather market in the custody or control of the Australian government, Howe, or any entity related to Howe."

6.2 The United States indicated that it was prepared to agree to appropriate procedures necessary to protect any business confidential information contained in the documents. The United States asserted that it had requested most of this

information in consultations with Australia, but the Australian government had to date been unwilling to provide it. The United States recalled that the Appellate Body Report in *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("*India - Patents*") stated:

> All parties engaged in dispute settlement under the DSU must be fully forthcoming from the very beginning both as to the claims involved in a dispute and as to the facts relating to those claims. Claims must be stated clearly. Facts must be disclosed freely. This must be so in consultations as well as in the more formal setting of panel proceedings. In fact, the demands of due process that are implicit in the DSU make this especially necessary during consultations. For the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of subsequent panel proceedings. If, in the aftermath of consultations, any party believes that all the pertinent facts relating to a claim are, for any reason, not before the panel, then that party should ask the panel in that case to engage in additional fact-finding.[12]

6.3 **Australia** responded that the obligation is upon the complainant, the United States, to come forward with the facts on which its case is based. There is no obligation upon Australia to provide the information sought by the United States. The United States could at any time have used the procedures of the SCM Agreement to seek information about the measures in question. Specifically, Australia pointed out, Article 25.8 of the SCM Agreement is the means by which a Member can seek information about measures of another Member. The United States chose not to use this procedural provision under the relevant agreement and so cannot expect that the information will be provided at its request in the Panel process.

6.4 The **United States** indicated that it had requested information, including information concerning notification of the subsidies as provided in Article 25.8 of the SCM Agreement, during consultations. According to the United States, at that time, Australia did not provide any of the requested information.

6.5 In **Australia**'s view, the United States was misrepresenting the situation in implying that it was analogous to that before the Appellate Body in *India - Patents*.[13] While the statement of the Appellate Body may have wider application, it was made in respect of a particular situation where the analogy for this case would be that there had been a substantial change affecting the measures before the Panel. Of course, it is within the scope of a Panel's working proce-

[12] WT/DS50/AB/R, adopted 16 January 1998, para. 94.
[13] *Ibid.*