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UNITED STATES - TAX TREATMENT FOR "FOREIGN SALES CORPORATIONS"

Report of the Panel
WT/DS108/R

Adopted by the Dispute Settlement Body
on 20 March 2000
as Modified by the Appellate Body Report

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I. INTRODUCTION

1.1 On 18 November 1997, the European Communities requested consultations with the United States under Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), Article XXIII:1 of GATT 1994, and Article 4 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") with respect to "Sections 921-927 of the Internal Revenue Code and related measures establishing special tax treatment for "Foreign Sales Corporations" ("FSCs")".[1]

1.2 On 4 March 1998, the European Communities requested the consultations "to be extended also to include consultations under Article 19 of the Agreement on Agriculture" ("AA").[2]

1.3 The European Communities and the United States held consultations on 17 December 1997, 10 February 1998, and 3 April 1998, but failed to reach a mutually satisfactory solution. On 1 July 1998, the European Communities requested the es-

[1] See the European Communities' request for consultations, WT/DS108/1 (28 November 1997).
[2] WT/DS108/1/Add.1 (12 March 1998).

tablishment of a panel under Article 6 of the DSU, Article 4 of the SCM Agreement, Article 19 of the AA, and Article XXIII of GATT 1994.[3]

1.4 At its meeting on 22 September 1998, the Dispute Settlement Body ("DSB") established a panel in accordance with Article 6 of the DSU with the following standard terms of reference:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the European Communities in document WT/DS108/2, the matter referred to the DSB by the European Communities in document WT/DS108/2, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."[4]

1.5 Barbados, Canada, and Japan reserved their rights to participate in the panel proceedings as third parties.

1.6 On 9 November 1998, the parties to the dispute agreed on the composition of the Panel as follows:

Chairman: Mr. Crawford Falconer

Members: Mr. Didier Chambovey

Professor Seung Wha Chang

1.7 The Panel met with the parties on 9-10 February 1999 and 16 March 1999. It met with the third parties on 10 February 1999.

II. ACTUAL ASPECTS

2.1 A FSC is a corporation created, organised, and maintained in a qualified foreign country or US possession outside the customs territory of the United States under the specific requirements of Sections 921-927 of the US Internal Revenue Code. A FSC obtains a US tax exemption on a portion of its earnings ("foreign trade income"), which means the gross income of a FSC attributable to "foreign trading gross receipts". Foreign trading gross receipts means the gross receipts of any FSC which are generated by qualifying transactions, which generally involve the sale or lease of "export property". Export property is:

- property held for sale or lease;
- manufactured, produced, grown, or extracted in the United States;
- by a person other than a FSC;
- sold, leased, or rented for use, consumption, or disposition outside the United States; and
- with no more than 50 per cent of its fair market value attributable to imports.[5]

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[3] WT/DS108/2 (9 July 1998).

[4] WT/DS108/3 (11 November 1998).

[5] Certain exceptions to this definition of export property may be found in Section 927(a)(2) of the IRC. They are: (a) property leased or rented by a FSC for use by any member of a controlled group of corporations of which such FSC is a member; (b) patents, inventions, models, designs, formulas, or processes whether or not patented, copyrights (other than films, tapes, records, or similar reproduc-

2.2 A FSC must meet certain requirements of foreign presence.[6] For example, a FSC must maintain an office outside the customs territory of the United States. That office must be equipped to transact the FSC's business. Also, in order for a FSC, other than a small FSC, to be treated as having foreign trading gross receipts for the taxable year, the management of the corporation during the taxable year must take place outside the United States, and the corporation can have foreign trading gross receipts from any transaction only if economic processes with respect to the transaction take place outside the United States.[7]

2.3 A portion of the "foreign trade income" is deemed to be "foreign source income not effectively connected with a trade or business in the United States" and is therefore not taxed in the United States[8]; this untaxed portion is referred to as the "exempt foreign trade income".[9] The remaining portion is taxable to the FSC. Dividends paid by the FSC out of exempt and non-exempt income to the shareholder (ordinarily, the "related supplier") generally qualify for a full dividends-received deduction.[10]

2.4 Special rules apply for agricultural cooperatives. Under certain circumstances, all of the foreign trade income that a FSC owned by a related qualified cooperative earns from the sale of agricultural or horticultural products will be treated as exempt foreign trade income.[11] However, no dividends-received deduction is permitted on a portion of the foreign trade income of a shareholder of an agricultural cooperative.[12]

2.5 With respect to the functions for which the FSC is responsible, in the case of a sale of export property to a FSC by a person described in Section 482 of the IRC (*i.e.*, by a related supplier), income is to be allocated to FSCs under one of three methods. One of these methods uses the prices actually charged between the FSC and the "related supplier" (*i.e.*, the United States parent), subject to the standard United States transfer pricing rules in Section 482 of the Internal Revenue Code.[13] The other two methods are "administrative pricing" rules, which FSCs and their parents are allowed to apply for the allocation of income between them.[14]

2.6 The first administrative pricing rule apportions 23 per cent of the total combined taxable income (that is, net income earned by the related supplier and the FSC together) derived from the sale of export property by the FSC and the remaining 77

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tions, and other than computer software (whether or not patented), for commercial or home use), good will, trademarks, trade brands, franchises, or other like property; (c) oil or gas (or any primary product thereof); (d) products the export of which is prohibited or curtailed to effectuate the policy set forth in paragraph (2)(C) of section 3 of the Export Administration Act of 1979 (relating to the protection of the domestic economy); and (e) any unprocessed timber which is a softwood. For purposes of subparagraph (e), the term "unprocessed timber" means any log, cant, or similar form of timber.

6 Section 922(a) of the IRC.

7 Section 924(b) of the IRC.

8 Such income is generally exempt from tax under section 882 of the Internal Revenue Code, if it is earned by a corporation resident outside the United States.

9 See Section 923(a) of the IRC.

10 Section 926(a) and 245(c) IRC.

11 See Section 923(a)(4) of the IRC.

12 See Section 245(c)(2)(B) of the IRC.

13 Exhibit EC-1.

14 See Sections 925(a) (1) and (2) of the IRC.

per cent to its related supplier. This rule further provides that 15/23 (approximately 65 per cent) of the FSC's foreign trade income is exempt from US tax.[15] Thus, this rule provides an exemption for 15 per cent (23 per cent x 15/23) of the total combined taxable income earned in the transaction.

2.7 The second administrative pricing rule allows the FSC to take 1.83 per cent of the total foreign trading gross receipts from the sale of export property as foreign trade income, not to exceed twice the amount allocable to the FSC under the combined taxable income method; *i.e.*, 46 per cent of the total combined (net) income earned in FSC transactions.[16] This rule further provides that 15/23 (approximately 65 per cent) of the FSC's foreign trade income is exempt from US tax. Thus, this rule provides an exemption for up to 30 per cent (46% x 15/23) of the total combined taxable income earned in the transaction. This 30 per cent exemption amount is only available, however, in limited circumstances. Because the ceiling for the gross receipts method is linked to the combined taxable (net) income method, it is not mathematically possible to receive the full 30 per cent exemption unless the profit margin on a transaction is 4 per cent or less. At a profit margin of 8 per cent or more, the exemption amount under the gross receipts method will be no more than 15 per cent under any circumstances.

2.8 A FSC must either itself perform or pay for specific economic processes related to the relevant export transaction. By statute, in order to qualify for the partial tax exemption, a FSC that uses administrative pricing rules must perform, contract, or pay for *all* of the distribution activities attributable to the export transaction.[17] These include the solicitation (other than advertising), negotiation, or making of the contract for the relevant FSC export transaction. At least one of these three important activities must be performed outside the United States. Additionally, the FSC must take responsibility for all of the following distribution activities, which must also be performed predominantly outside the United States:

(a) Advertising and sales promotion;

(b) Processing of customer orders and arranging for delivery;

(c) Transportation of goods involved in the transaction to the customer;

(d) Determination and transmittal of final invoice or statement of account, and receipt of payment; and,

(e) Assumption of credit risk.[18]

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

A. Findings of Law

3.1 The European Communities requests the Panel to make the following findings of law:

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15 See Sections 923(a)(3) and 291(a)(4) of the IRC.
16 See Section 925(d) of the IRC.
17 See Section 925(c) of the IRC.
18 Section 924(d) and (e) of the IRC.

3.2 That, by maintaining the tax exemptions and special administrative pricing rules contained in the FSC scheme, the United States has violated:

(a) Article 3.1(a) of the SCM Agreement by granting subsidies contingent in law upon export performance;

(b) Article 3.1(b) of the SCM Agreement by granting subsidies contingent in law upon the use of domestic over imported goods; and

(c) Articles 3 and 8 read in conjunction with Articles 9.1(d), 10.1, and 10.3 of the AA by granting export subsidies to agricultural goods in excess of its reduction commitments under that Agreement (e. g. wheat, maize, soya beans, and cotton);

(d) And that, by doing so, it has nullified and impaired benefits accruing to the European Communities under those agreements.

3.3 The **United States** requests the Panel to make the following findings of law:

That neither the FSC tax exemption nor the FSC administrative pricing rules violate:

(a) Article 3.1(a) of the SCM Agreement;

(b) Article 3.1(b) of the SCM Agreement; or

(c) Articles 3 and 8 read in conjunction with Articles 9.1(d), 10.1, and 10.3 of the AA; and

(d) That neither the FSC tax exemption nor the FSC administrative pricing rules nullify or impair benefits accruing to the European Communities under the SCM Agreement or the AA.

B. Recommendations

3.4 In its first oral and second written submissions, the **European Communities** requests the Panel to recommend that the United States withdraw the two FSC subsidies before the beginning of the next tax year (fiscal year 2000).

3.5 The **United States** maintains that it is premature to address questions of implementation, an issue which could be taken up, if necessary, during the interim review process. The United States further maintains that the time-frame suggested by the European Communities is inappropriate and unrealistic.

3.6 In its second oral submission to the Panel, the European Communities requests the Panel to recommend that the United States withdraw the two FSC subsidies by 1 October 1999 in the absence of an appeal and, in any event, before 1 October 2000 (the beginning of its fiscal year 2001).

IV. MAIN ARGUMENTS OF THE PARTIES

A. Preliminary Objections

4.1 In its Request for Preliminary Findings, the **United States** requests that the Panel:

(1) dismiss the European Communities' claims under Article 3 of the SCM Agreement due to the European Communities' failure to include in its request for consultations a statement of available evidence with

regard to the existence and nature of the subsidy in question, as it was required to do by Article 4.2 of the SCM Agreement;

(2) dismiss or defer the European Communities' complaint due to the European Communities' failure to raise transfer pricing concerns regarding the FSC, in the first instance, in an appropriate tax forum, as it was required to do by footnote 59 of the SCM Agreement;

(3) find that, by failing to identify the agricultural products covered by its claims under the AA, the European Communities' request for the establishment of a panel failed to comply with Article 6.2 of the DSU; and that because of this failure, the European Communities' claims under the AA should be dismissed; and

(4) find that the measures at issue in this dispute are limited to Section 921-927 of the US Internal Revenue Code (the FSC statute).

The **European Communities** makes the following general comments:

4.2 A number of the objections raised by the United States are matters which the United States ought to have raised before the establishment of the Panel, during the consultations or at the meeting of the DSB at which the request for the establishment of the Panel was considered. It did not do so, and the European Communities was led to believe that the United States had no objections to the information which the European Communities had provided about the nature of its complaint or to the jurisdiction of a panel to hear this case. The United States is in any event estopped from raising these objections now. Raising these issues after the Panel has been established obstructs the efficient conduct of dispute settlement.

4.3 A WTO Member against whom the establishment of a Panel is requested has at least two formal occasions at which to raise objections as to the jurisdiction of a dispute settlement panel and the regularity of the procedure leading up to the establishment of the panel. This is at the meetings of the DSB. Objections raised at this time can and do lead to a withdrawal of the request and a rectification of any defect.

4.4 In the present case, no objections were made at the meetings of the DSB when the establishment of this Panel was discussed. Indeed, at the meeting of the DSB at which this Panel was established, the representative of the United States, after referring to her statement at the previous meeting of the DSB on 23 July 1998, stated that:

> "She only wished to state that the European Communities' reinstitution of a matter considered by the United States as resolved was a legally unwarranted and commercially unjustified action which would not prove helpful to the multilateral trading system or to the United States bilateral relationship with the European Communities and its member States. The United States was confident to prevail on the merits of this case and would state its arguments before the panel."

4.5 The European Communities therefore considers that raising procedural objections to the jurisdiction of the Panel and the regularity of the pre-establishment procedure instead of arguing on the merits is deliberately obstructive of the dispute settlement process and an abuse of procedure. The first, second, and third of the

United States requests for preliminary findings should therefore be dismissed already for this reason.

4.6 The European Communities requests the Panel to reject the requests by the United States for "preliminary findings" and other rulings at its first meeting or as soon as possible thereafter.

The **United States** makes the following general comments:

4.7 In the United States' Request for Preliminary Findings and the First US Submission[19], the United States objected to the European Communities' failure to provide a "statement of available evidence with regard to the existence and nature of the subsidy in question" and its failure to identify the agricultural products at issue in its claims under the AA. These failings were in violation of the requirements of Article 4.2 of the SCM Agreement and Article 6.2 of the DSU.[20] In addition, because the European Communities has failed to specify any "related measures", it necessarily has limited its claims to the FSC statute itself.

4.8 Because of these procedural failings, it was not until the European Communities presented its First Submission to the Panel on 21 December 1998 ("First European Communities Submission") that the United States first learned the European Communities' theory of its case and its perceptions of the purpose and operational effects of the FSC. That submission revealed for the first time that the European Communities based its claims on a legal premise that the United States finds to be remarkable; namely, that the principle that Members may, but need not, tax income generated from foreign economic activities - a principle originally proposed by European Communities member States and endorsed by the European Communities itself - is not a part of the SCM Agreement or otherwise applicable to this case. The First European Communities Submission revealed that, at the very least, the European Communities and the United States have fundamentally different views of the legal framework within which this dispute should be decided.

4.9 The First European Communities Submission further revealed an European Communities perception of the FSC and of the purpose underlying its enactment that is totally different from that which the Congress of the United States articulated at the time the FSC was adopted. Accordingly, the European Communities has made numerous arguments that, in the view of the United States, are irrelevant in light of the legislative purpose that Congress sought to achieve through the FSC. When combined with entirely different views of key legal provisions - the meaning of the term "arm's length" in footnote 59, for example - the arguments of the First European Communities Submission and the arguments of the United States in its First Submission do not address common issues.

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[19] Request by the United States for Preliminary Findings (4 December 1998); First Submission of the United States of America (25 January 1999).

[20] To clarify matters for the Panel, the United States hereby confirms that, in light of the discussion that took place at the first meeting of the Panel, it has withdrawn its objection concerning the European Communities' failure to identify *non-scheduled* agricultural products. The United States continues to maintain, however, that the European Communities' failure to identify s*cheduled* agricultural products in its request for the establishment of a panel violated Article 6.2 of the DSU.

4.10 Because such fundamental differences were never exposed and addressed during the consultations phase of this case, the real issues before the Panel will be joined, if at all, only very late in the Panel process. Both this rebuttal brief and the European Communities' simultaneous rebuttal brief, rather than engaging one another on the fine points and implications of the opposing parties' main arguments, will in many respects still be attempting to define the basic issues in this case. One resulting risk is that the central issues will not have been explored and tested as fully as they might have been had the true issues been identified earlier in the process.

4.11 More important, perhaps, is that the procedural failings in the early stages of this dispute have effectively foreclosed - as subsequent submissions to this Panel have confirmed - meaningful consultations on the complex issues of this case. Because the fundamental differences in the views of the European Communities and the United States on the controlling legal standard emerged only through submissions to the Panel, it was not possible to engage that issue and explore the implications of the two contrasting views during the consultation process. Similarly, because it was only the European Communities' submission on the merits to this Panel that surfaced what, in the view of the United States, is a fundamental misperception by the European Communities of the purpose and rationale of the FSC, there was no opportunity during the consultation period to engage in a dialogue about those basic, primarily factual, differences.

4.12 The consultation process is an integral part of the WTO dispute settlement process. The requirements that a complaining Member must identify the measures at issue, indicate the legal basis for its complaint, and provide a statement of the available evidence on the nature of any alleged subsidy are all mandatory steps in making a request for consultations, which the complaining Member is required to do. Their obvious purpose is to enable the parties to engage in informed, meaningful consultations. In this case, consultations took place without any statement of available evidence or disclosure of the legal basis and factual assumptions that emerged for the first time in the First European Communities Submission. Although a Panel cannot monitor consultations or force them to be substantive, a Panel at least can ensure that the required preconditions to consultations are satisfied.

4.13 These procedural preconditions, and the consultation process for which they are intended to prepare the way, are singularly important in the context of this dispute. This is a particularly complex case. As reflected in the first submissions of the parties and the questioning that took place at the first meeting of the Panel, questions relating to the controlling legal standard are themselves complicated and implicate provisions of the SCM Agreement that have lineages that stretch back decades. The tax provisions of the FSC are also complex, as they must be construed and understood in the context of the tax system of the United States, of the *Tax Legislation Cases* decided by a GATT panel in the 1970s, of the GATT Council Decision of 1981, of the Congressional purpose of implementing and adhering to that Decision, and of provisions of the SCM Agreement that incorporate many years of prior practice. It would be difficult to posit a case in which careful consultations would have been more important.

4.14 The significance of the European Communities' procedural failings is reinforced, finally, by the last procedural requirement that the United States has referenced and that the European Communities has failed to honour. In contrast to the treatment of most other types of disputes, footnote 59 of the SCM Agreement spe-

cifically requires that when a Member believes that another Member is acting contrary to the "arm's length" principle of footnote 59, those Members shall attempt to resolve their differences through an alternative forum specialized in the technical aspects of the dispute. The language used in footnote 59 - that Members "shall normally" seek to resolve such differences in an alternative forum - has been construed by a panel in another context to be a mandatory requirement.[21]

4.15 This unusual provision deferring to more specialised facilities and mechanisms - which first appeared in footnote 2 to the Illustrative List attached to the Tokyo Round Subsidies Code and for which there does not appear to be any comparable provision in the realm of the WTO - has direct applicability to the technical dispute before this Panel. Not only are the intricate details of the tax provisions at issue in this case complex, but also the implications that any final Panel decision on the merits may have on the varied tax systems of the WTO's more than 130 Members could be very far-reaching. Issues of such scope deserve the concentrated attention of specialised fora.

4.16 In the context of the procedural issues in this case, the provision of footnote 59 referring Members to alternative fora reinforces the importance of detailed, substantive consultations. If the SCM Agreement goes so far as to urge Members to take such issues to more specialised fora, that provision, even if this Panel were to deem it non-binding, plainly underscores the importance of enforcing the procedural provisions designed to lead to informed, detailed consultations before asking a Panel to decide the matter on its merits.

4.17 For all of these reasons, the United States believes that this Panel should decline to decide the merits of this case at this time. The European Communities' procedural failings here have prevented meaningful consultations. The issues are just now being joined. The factual claims and counter-claims have not yet been explored or reconciled, and the parties have had no meaningful dialogue on the implications of the issues of this case for both worldwide and territorial tax systems. The United States therefore urges, first, that this matter be dismissed in order to allow the Parties to first address the issues raised, as footnote 59 requires, through bilateral or multilateral tax mechanisms and authorities. Alternatively, the United States urges that this case be dismissed in order to assure that the merits of this dispute, if not otherwise resolved, come to a WTO panel only after the procedural requirements designed to facilitate meaningful consultations have been satisfied.

1. Statement of Available Evidence - Article 4.2 of the SCM Agreement

The **United States** argues as follows:

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[21] *United States - Imposition of Anti-Dumping Duties on Imports of Stainless Steel Hollow Products from Sweden*, ADP/47, Report of the Panel issued 20 August 1990 (unadopted), paragraph 5.20, in which the panel, referring to the phrase "shall normally" as used in Article 5.1 of the Tokyo Round Antidumping Code with respect to the "on behalf of" requirement, stated that "[t]he plain language in which this provision is worded, and in particular the use of the word 'shall', indicates that this is an essential procedural requirement for the initiation of the investigation to be consistent with the Agreement."

4.18 In making its request for consultations in this dispute, the European Communities failed to include a "statement of available evidence" as required by Article 4.2 of the SCM Agreement. As a result, the European Communities' claims under Article 3 of the SCM Agreement are not properly before the Panel and should be dismissed.

4.19 The general rules governing requests for dispute settlement consultations are found in Article 4.4 of the DSU, which provides as follows:

> "All such requests for consultations shall be notified to the DSB and the relevant Councils and Committees by the Member which requests consultations. Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint."

4.20 Thus, under Article 4.4, a valid request for consultations must meet the following requirements:

(1) The request must be notified to the DSB and the relevant Councils and Committees by the Member requesting consultations.

(2) The request must be submitted in writing.

(3) The request must identify the measures at issue.

(4) The request must identify the legal basis for the complaint.

These four requirements are not at issue here.

4.21 However, Article 4.2 of the SCM Agreement adds a fifth requirement in the case of requests for consultations concerning alleged prohibited subsidies, a requirement that the European Communities did not satisfy. Specifically, Article 4.2 provides as follows: "A request for consultations under paragraph 1 *shall* include a statement of available evidence with regard to the existence and nature of the subsidy in question." (Emphasis added)

4.22 The European Communities invoked Article 4 of the SCM Agreement as the basis for both its consultations and panel requests with respect to the SCM Agreement. Accordingly, the obligation to include a "statement of available evidence" under Article 4.2 is *mandatory*, as the drafters of the SCM Agreement made clear by using the term "shall".[22] Therefore, by the terms of Article 4.2, any request for consultations under Article 4.1 *must* include a statement of available evidence.

4.23 As noted, the requirement of Article 4.2 to include a statement of available evidence applies to this proceeding. Under Appendix 2 to the DSU, Article 4.2 is identified as a special or additional rule and procedure. As such, under Article 1.2, first sentence, of the DSU, the requirements for consultation requests in Article 4.4 of the DSU "apply subject to" the requirements of Article 4.2 of the SCM Agreement. Thus, a request for consultations that complies with Article 4.4 of the DSU,

[22] Such an interpretation accords to Article 4.2 the ordinary meaning of its terms in their context, consistent with the customary principles of treaty interpretation as set forth in Article 31 of the *Vienna Convention on the Law of Treaties*. *See, e.g.*, Report of the Appellate Body *Japan - Alcoholic Beverages II*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97, at 104-105.

but that fails to include a statement of available evidence as required by Article 4.2 of the SCM Agreement, is not a proper request.[23]

4.24 In its recent decision in the *Guatemala Cement* case, the Appellate Body interpreted the relationship between the general provisions of the DSU and the "special or additional rules and procedures" listed in Appendix 2. The Appellate Body stated as follows:

> "[T]hese special or additional rules and procedures "shall prevail" over the provisions of the DSU "[t]o the extent that there is a *difference* between" the two sets of provisions (emphasis added). Accordingly, if there is no "difference", then the rules and procedures of the DSU apply *together with* the special or additional provisions of the covered agreement."[24]

4.25 Because Article 4.2 of the SCM Agreement adds to and is otherwise consistent with Article 4.4 of the DSU, it must be read together with Article 4.4. Together, these two provisions establish the requirements for consultation requests concerning claims under Article 3 of the SCM Agreement. These requirements are mandatory, and should be enforced in this dispute.

4.26 As is by now well-established, the provisions of the various WTO agreements must be interpreted in accordance with Article 31 of the *Vienna Convention on the Law of Treaties* ("*VCLT*"), paragraph 1 of which provides as follows: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." An application of Article 31(1) of the *VCLT* to Article 4.2 of the SCM Agreement reveals that the European Communities' request for consultations failed to satisfy the requirements of Article 4.2.

4.27 The ordinary meaning of the term "evidence" is as follows: "Facts or testimony in support of a conclusion, statement or belief."[25] Thus, based on its ordinary meaning, and as applied to this dispute, Article 4.2 required the European Communities to include in its request for consultations a statement of available *facts* from which one could conclude that the FSC provisions constitute a prohibited subsidy. The European Communities was required to do something more than merely assert the ultimate conclusion.

4.28 This result is reinforced by considering the context of Article 4.2, which under Article 31(2) of the *VCLT* includes other provisions of the SCM Agreement.[26] Article 11.2 of the SCM Agreement, which deals with the contents of countervailing duty applications, provides as follows:

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[23] This conclusion is reinforced by Article 30 of the SCM Agreement, which provides that the provisions of the DSU "shall apply to *consultations* and the settlement of disputes under this Agreement, *except as otherwise specifically provided herein.*" (Emphasis added)

[24] *Guatemala - Anti-Dumping Investigation Regarding Portland Cement from Mexico* (Guatemala – Cement I), WT/DS60/AB/R, Report of the Appellate Body adopted 25 November 1998, DSR 1998:IX, 3767, paragraph 65 (emphasis in original).

[25] *The New Shorter Oxford English Dictionary* (1993).

[26] *Brazil - Measures Affecting Desiccated Coconut* ("Brazil – Desiccated Coconut), WT/DS22/AB/R, Report of the Appellate Body adopted 20 March 1997, DSR 1997:I, 167, at 182, in which the Appellate Body interpreted Article 32.3 of the SCM Agreement in conjunction with Articles 10 and 32.1 of that agreement.

4.29 "An application under paragraph 1 shall include sufficient evidence of the existence of *(a)* a subsidy and, if possible, its amount, *(b)* injury within the meaning of Article VI of GATT 1994 as interpreted by this Agreement, and *(c)* a causal link between the subsidized imports and the alleged injury. *Simple assertion, unsubstantiated by relevant evidence*, cannot be considered sufficient to meet the requirements of this paragraph." (Underscoring added)

4.30 The second sentence of Article 11.2 makes clear that the drafters of the SCM Agreement carefully distinguished between an "assertion" and "evidence."

4.31 Nothing in the European Communities' initial request for consultations even purports to be a statement of available *evidence*.[27] Instead, the pertinent part of the European Communities' request contains simply a conclusory legal assertion, merely citing the provisions of the SCM Agreement on which the European Communities relies. As demonstrated above, *assertions* are not *evidence*. Therefore, the European Communities' request failed to satisfy the requirements of Article 4.2.

4.32 Likewise, the European Communities' second request for consultations with the United States did not contain a statement of available evidence. Rather, this second request merely sought to extend the ongoing consultations to include consultations under Article 19 of the AA.[28] This second consultation request did not refer to or modify the European Communities' claims under Article 3 of the SCM Agreement, and, thus, did not cure the defect in the European Communities' initial request for consultations.

4.33 In short, the European Communities' two requests for consultations in this dispute contain no information whatsoever as to the evidence available to the European Communities regarding the existence and nature of the alleged subsidy in question. As such, the European Communities' claims under Article 3 of the SCM Agreement do not conform to the requirements of Article 4.2 of that agreement.

4.34 In view of the mandatory requirement of Article 4.2 of the SCM Agreement, and the European Communities' failure to meet it, the Panel should dismiss the European Communities' prohibited subsidy claims. Any other result would render Article 4.2 ineffective, an outcome that the Appellate Body repeatedly has stated is not acceptable under applicable rules of treaty interpretation.[29]

4.35 Moreover, the Appellate Body recently clarified in the clearest possible terms that a complainant in a WTO dispute is not free to disregard procedural requirements. In the *Guatemala Cement* case, the Appellate Body threw out an entire dispute that had been fully litigated before a panel because Mexico had failed to specify, as it was required to do by Article 6.2 of the DSU, whether it was challenging Guatemala's preliminary or final anti-dumping determination on cement from Mexico.[30] According to the Appellate Body, "the Panel did not consider whether Mexico had properly

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27 WT/DS108/1.

28 WT/DS108/1/Add. 1.

29 *See, e.g., United States - Standards for Reformulated and Conventional Gasoline* ("US – Gasoline), WT/DS2/AB/R, Report of the Appellate Body adopted 20 May 1996, DSR 1996:I, 3, at 21 ("An interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility.").

30 Appellate Body Report, Guatemala – Cement I, Supra, FN 24.

identified a relevant anti-dumping measure in its panel request and, therefore, it erred in finding that this dispute was properly before it."[31]

4.36 The clear requirement of Article 4.2, the European Communities' failure to satisfy that requirement, and the Appellate Body's teachings in the *Guatemala Cement* case require the Panel to dismiss the European Communities' claims under Article 3 of the SCM Agreement. The European Communities' consultations request was fatally flawed, and therefore the European Communities' panel request with respect to the SCM Agreement is also fatally flawed.

4.37 The European Communities' failure to include a statement of available evidence has deprived (1) the United States of its *right* to learn of the existence of such evidence in advance of the consultations held in this matter, and (2) the dispute settlement system of the benefits that Article 4.2 was designed to provide. By requiring a complainant to include a statement of available evidence in its request for consultations, Article 4.2 creates conditions that are more favourable to Members reaching a mutually acceptable resolution of a dispute. It does so by allowing for a more thorough airing of the factual basis on which the complaining party requested consultations and by providing a preview of the evidence the complaining party is likely to rely on if the matter is presented to a panel.

4.38 Article 4.3 of the SCM Agreement makes this point explicitly, stating that "[t]he purpose of the consultations is to clarify the facts of the situation and to arrive at a mutually agreed solution." This objective of clarifying the facts cannot be fulfilled when, as in this case, the party requesting consultations fails to comply with an express requirement that it state what facts are available to it.

4.39 In light of the European Communities' failure to comply with Article 4.2 of the SCM Agreement, fundamental fairness requires that the European Communities not be given the inappropriate advantage of relying on evidence during the Panel's proceedings that it was required to identify in its consultation request. As the Appellate Body has stated:

4.40 "[A]ll 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 clearly stated. 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 made 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."[32]

4.41 The Appellate Body's reasoning is particularly pertinent to the present dispute. Had the European Communities complied with Article 4.2, the United States would have been afforded a more meaningful opportunity to assess the strength or weakness of the European Communities' allegations, the United States would have had the opportunity to comment on the European Communities' evidence during consultations, and, accordingly, the consultations between the European Communities

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[31] Appellate Body Report, Guatemala – Cement I, Supra, FN 24, paragraph 88.

[32] *India - Patent Protection for Pharmaceutical and Agricultural Chemical Products* ("India – Patents (US)"), WT/DS50/AB/R, Report of the Appellate Body adopted 16 January 1998, DSR 1998:I, 9, paragraph 94.

and the United States might have resulted in a mutually agreeable resolution of the dispute.

4.42 To fail to dismiss the European Communities' claims with respect to the SCM Agreement would, in effect, permit the European Communities (or any other WTO Member) to ignore Article 4.2 with impunity. Article 4.2 would be reduced to redundancy or inutility, an outcome that, as noted above, is contrary to basic principles of public international law.

4.43 Because the European Communities' request for consultations did not contain a statement of available evidence, as required by Article 4.2 of the SCM Agreement, the Panel should dismiss the European Communities' claims under Article 3 of the SCM Agreement.

The **European Communities** responds as follows:

4.44 The United States does not seem to be arguing that Article 4.2 of the SCM Agreement requires a statement of available evidence in a *separate document*. Nor can it argue that there must be a *separate section* in any request for consultations under Article 4 of the SCM Agreement (or indeed Article 7 of the SCM Agreement, which contains in Article 7.2 a similar provision to Article 4.2) using the words "available evidence". Nothing in the wording of Article 4.2 of the SCM Agreement requires this. The practice under Article 4.2 of the SCM Agreement, including consultation requests made by the United States, support this. The European Communities refers the Panel to the United States requests for consultations In *Brazil - Certain Measures Affecting Trade And Investment In The Automotive Sector*[33]*; Indonesia - Certain Measures Affecting The Automobile Industry*[34]*; Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*[35]*; Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products*[36]*; European Communities - Measures Affecting the Exportation of Processed Cheese*[37]*; Belgium - Certain Income Tax Measures Constituting Subsidies*[38]*; Netherlands - Certain Income Tax Measures Constituting Subsidies*[39]*; Greece - Certain Income Tax Measures Constituting Subsidies*[40]*; Ireland - Certain Income Tax Measures Constituting Subsidies*[41]*; France - Certain Income Tax Measures Constituting Subsidies.*[42] The only one of these requests which expressly refers to "evidence" is the United States second request for consultations in *Australia - Subsidies Provided to Produc-*

[33] There were two requests. See documents WT/DS52/1-G/L/99-G/SCM/D5/1-G/TRIMS/D/2 (14 August 1996) and WT/DS65/1-G/L/139-G/SCM/D10/1-G/TRIMS/D/6 (17 January 1997).
[34] Document WT/DS59/1-G/L/117-G/TRIMS/D/5-G/SCM/D8/1-IP/D/6 (15 October 1996).
[35] There were two requests. See documents WT/DS106/1-G/SCM/D17/1 and WT/DS126/1-G/SCM/D20/1.
[36] WT/DS103/1-G/L/192-G/AG/GEN/12-G/SCM/D15/1-G/LIC/D/13 (13 October 1997).
[37] WT/DS104/1.
[38] WT/DS127/1.
[39] WT/DS128/1.
[40] WT/DS129/1.
[41] WT/DS130/1.
[42] WT/DS131/1.

ers and Exporters of Automotive Leather[43] which, significantly, involves a complex case of *de facto* export subsidy and the evidence provided by the United States related to the export contingency.

4.45 Article 4.2 of the SCM Agreement, just like Article 7.2 of the SCM Agreement in the case of actionable subsidies, is a specific application to the case of subsidies of the general principle set out in the second sentence of Article 4.4 of the DSU that "[a]ny request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint." The purpose of these provisions is to ensure that the problem that is to be the subject of the consultations is clearly explained. The reason why Article 4.2 of the SCM Agreement (and Article 7.2 of the SCM Agreement) specifically provide for the available evidence to be stated is that in subsidy cases the factual circumstances will often be important for understanding the problem.

4.46 The European Communities did provide a statement of available evidence. We are not concerned in this case with a disguised subsidy arising out complex factual circumstances in a particular sector but with a straightforward subsidy arising out of a generally applicable law. The European Communities referred to the relevant United States legal provisions - Sections 921 to 927 of the IRC. That was the available evidence.

4.47 In contrast to the case of *Australia - Subsidies Provided to Producers and Exporters of Automotive Leather*, referred to above, the FSC scheme is a case where the export contingency derives from the law and therefore no further "evidence" is required than the law itself. The same is also true of the requirement to use domestic over imported goods.

4.48 The United States insists that "evidence" means facts and claims that the European Communities' request contains none. It bases this claim on an obvious error. It refers to the legal claim (the "conclusory legal assertion") as being the pertinent part of the request for consultations. The facts referred to by the European Communities are stated before the legal claim in the earlier part of the request for consultations.

4.49 The facts of this case are the United States law, and the European Communities' request for consultations did refer to it, as this was the available evidence. The United States must be presumed to know its own law and is presumably not arguing that the European Communities should have set out the text of the law in its request.

4.50 The European Communities' approach in this case of referring to the legal provisions and not setting out the detail in the request for consultations was also followed by the United States in its requests for consultations under Article 4 of the SCM Agreement.

4.51 The United States, ignoring the fact that the European Communities did refer to the available evidence, continues its false reasoning by invoking Article 11.2 of the SCM Agreement. It relies on the distinction made in this provision between "sufficient evidence" and "simple assertion" and suggests that the European Communi-

[43] WT/DS126/1-G/SCM/D20/1.