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THE WTO DISPUTE SETTLEMENT REPORTS

The *Dispute Settlement Reports* of the World Trade Organization (the "WTO") include panel and Appellate Body reports, as well as arbitration awards, in disputes concerning the rights and obligations of WTO Members under the provisions of the *Marrakesh Agreement Establishing the World Trade Organization*. The *Dispute Settlement Reports* are available in English, French and Spanish. Starting with 1999, the first volume of each year contains a cumulative index of published disputes.

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Adopted by the Dispute Settlement Body
on 19 June 2000
as Modified by the Appellate Body Report

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I. PROCEDURAL HISTORY

1.1 This proceeding has been initiated by two complaining parties, Japan and the European Communities.

A. Consultations

1.2 In a communication dated 3 July 1998 (WT/DS139/1), Japan requested consultations with Canada in accordance with Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), pursuant to Article XXIII of the General Agreement on Tariffs and Trade 1994 (GATT), Article 8 of the Agreement on Trade-Related Investment Measures (TRIMs Agreement) (to the extent that Article 8 invokes Article XXIII of GATT 1994), Articles 4 and 30 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) (to the extent that Article 30 refers to Article XXIII of GATT 1994), and Article XXIII:1 of the General Agreement on Trade and Services (GATS), with respect to certain Canadian measures affecting the automotive industry. Japan and Canada held consultations in Geneva on 27 August 1998, but these consultations did not result in a resolution of the dispute.

1.3 In a communication dated 17 August 1998 (WT/DS142/1), the European Communities requested consultations with Canada pursuant to Article 4 of the DSU, Article XXIII:1 of GATT 1994, Article 8 of the TRIMs Agreement, Articles 4 and 30 of the SCM Agreement, and Article XXIII:1 of the GATS, concerning certain measures affecting the automotive sector. The European Communities and Canada held consultations on 21 September and 13 November 1998, but these consultations did not result in a resolution of the dispute.

1.4 On 12 November 1998 Japan (WT/DS139/2) and on 14 January 1999 the European Communities (WT/DS142/2) each requested the establishment of a panel pursuant to Articles 4.7 and 6 of the DSU.

B. Establishment and Composition of the Panel

1.5 At its meeting on 1 February 1999, the DSB established a Panel pursuant to the requests by Japan and the European Communities. The DSB agreed, pursuant to Article 9.1 of the DSU, that a single panel should examine both complaints.

1.6 At that meeting, the parties to the dispute agreed that the Panel should have standard terms of reference provided for in Article 7.1 of the DSU. The terms of reference of the Panel are the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Japan and the European Communities in documents WT/DS139/2 and WT/DS142/2 respectively, the matter referred to the DSB by Japan and the European Communities in those documents and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.7 On 15 March 1999, the European Communities and Japan jointly requested the Director-General, pursuant to Article 8.7 of the DSU, to determine the composi-

tion of the Panel. The Director-General accordingly determined the composition of the Panel (WT/DS139 and 142/3) as follows:

Chairman:	Mr. Ronald Saborío Soto
Members:	Mr. Timothy Groser
	Mr. Rudolf Ramsauer

1.8 India, Korea and the United States reserved their third-party rights in the dispute.

C. Panel Proceedings

1.9 The Panel met with the parties on 14 and 15 June 1999 and on 13 and 14 July 1999. The Panel held a third-party session on 15 June 1999.

II. BACKGROUND

2.1 This dispute concerns Canadian measures which accord to certain motor-vehicle manufacturers established in Canada the right to import motor vehicles with an exemption from the generally applicable customs duty.

2.2 To qualify for the exemption, an eligible manufacturer's local production of motor vehicles (including in certain cases the production of parts) must achieve a minimum amount of Canadian value added (CVA), and its local production must maintain a minimum ratio ("production-to-sales" ratio) with respect to its sales of motor vehicles in Canada.

A. The Auto Pact

2.3 The measures at issue in this case stem from the Agreement Concerning Automotive Products Between the Government of Canada and the Government of the United States (the "Auto Pact"), a treaty between Canada and the United States concluded in January 1965. Under the Auto Pact, Canada agreed to accord duty-free treatment to vehicles and original equipment manufacturing parts[1] of the United States[2], provided the importer met the definition of a motor vehicles "manufacturer" under the terms of the Auto Pact. An Auto Pact manufacturer must have produced in Canada, during the base year (1963-64), motor vehicles of the class it is importing, and (i) must have maintained a ratio of the sales value of its local production of vehicles of that class to the vehicles of that class sold in Canada of a prescribed minimum, and (ii) must have achieved a minimum amount of CVA in its local production of motor vehicles (including in certain cases the production of parts therefor).[3] The

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1 Excluding tires and tubes.

2 Article II(a) of the Auto Pact.

3 Para. 2 of Annex A of the Auto Pact defines a manufacturer as one that:

"(i) produced vehicles of that class in Canada in each of the four consecutive three months' periods in the base year, and

(ii) produced vehicles of that class in Canada in the period of twelve months ending on the 31st day of July in which the importation is made,

(A) the ratio of the net sales value of which 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

Auto Pact also provided that Canada could designate a manufacturer not meeting the base year criterion to import duty-free motor vehicles and original equipment manufacturing parts.[4]

1. Letters from Auto Pact Manufacturer Beneficiaries to Industry Canada

2.4 Prior to the conclusion of the Auto Pact, the Canadian Government requested from the Auto Pact manufacturers certain Letters specifying how each company viewed its operations in relation to the Auto Pact. While the Letters were not released publicly, those of General Motors of Canada, Ltd., Ford Motor Company of Canada, Ltd., Chrysler Canada, Ltd., and American Motors[5] were made public in hearings of the US Congress on the Automotive Products Trade Act, 1965 (the US implementing legislation for the Auto Pact).

2.5 The Letters address similar issues, and some of them are framed in similar and, in parts, identical language. The complainants contend that these Letters contain additional CVA requirements and constitute binding undertakings. The respondent contends that the Letters are not binding, that they contain no such requirements, and that the only evidence on the record indicates that the Letters are not binding. The parties' arguments relating to the status of these Letters are found in Section V (Factual Arguments of the Parties) and in Section VI (Legal Arguments of the Parties).

2. GATT Working Party Examination of the Auto Pact

2.6 In March 1965 a GATT Working Party was established to examine the Auto Pact.[6] The Working Party found that the US application of the Auto Pact would violate the GATT:

> "It was the general consensus of the Working Party that, if the United States implemented the Agreement in the manner proposed, United States action would be clearly inconsistent with Article I and it would be necessary for the United States Government to seek a waiver from its GATT obligations."[7]

2.7 The United States sought and obtained a waiver under Article XXV:5.[8] In November 1996 that waiver was renewed at the request of the United States[9], until

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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 seventy-five to one hundred; and

(B) the Canadian value added of which is equal to or greater than the Canadian value added of all vehicles of that class produced in Canada by the manufacturer in the base year."

4 Para. 3 of Annex A of the Auto Pact.

5 American Motors was acquired by Chrysler in 1987.

6 Report of the *Working Party on Canada - US Agreement on Automotive Products*, submitted to the Council of Representatives 19 November 1965, BISD 13S/112 (hereinafter Report of the *Working Party on Canada - US Agreement on Automotive Products*).

7 Ibid., para. 17.

8 Ibid., para. 15; Decision of the Contracting Parties of 20 December 1965 granting the waiver requested by the United States, BISD 14S/37.

9 G/L/103.

1 January 1998[10], when the duties on imports of Canadian automotive products were fully eliminated in accordance with the provisions of the North American Free Trade Agreement (NAFTA).

2.8 When the Working Party went on to examine the relationship between Canada's Auto Pact obligations and the GATT, members noted that, in his introductory remarks, "the representative of Canada had stressed that his Government was implementing the Agreement on a most-favoured-nation basis and was extending to all contracting parties the same tariff benefits, on the same terms, as it had undertaken to grant the United States under the Agreement."[11] Although some members questioned whether Canada's application of the Auto Pact was compatible with GATT Articles I and III[12], there was no consensus in the Working Party on whether or not Canada was in violation of its GATT commitments.

B. The Canada - United States Free Trade Agreement (CUSFTA)

2.9 Trade in automotive products was also affected by the Canada - United States Free Trade Agreement (CUSFTA)[13], which entered into force 1 January 1989. The CUSFTA provided for the elimination of duties on automotive products by 1 January 1998, so long as the products qualified under CUSFTA origin rules.

2.10 The CUSFTA also changed the Auto Pact provisions which had allowed the Canadian Government to designate additional manufacturers to benefit from the duty exemption.[14] It did so by limiting eligibility for the import duty exemption to firms falling into one of three categories:[15] (i) Auto Pact manufacturers; (ii) manufacturers designated by the Canadian Government as beneficiaries prior to the signing of the CUSFTA; and (iii) other firms which were expected to be designated by the Canadian Government by the 1989 model year.[16] In other words, the CUSFTA had the effect of closing the list of those entitled to import duty free, after a grace period for certain potential new entrants, so that the only way a company outside those categories might be authorized to import duty free pursuant to this programme would be by acquiring control of, or being acquired by, a beneficiary.[17]

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[10] Decision adopted by the General Council at is meeting of 7, 8 and 13 November 1996, WT/L/198.

[11] Report of the *Working Party on Canada - US Agreement on Automotive Products*, *supra* note 6, para. 20.

[12] Ibid., paras. 21 and 22.

[13] Exhibits EC-12 and JPN-33.

[14] Auto Pact, Annex A, para. 3.

[15] Annex to Article 1002.1 of the CUSFTA.

[16] The last category was added in order to allow CAMI, a joint venture between General Motors and Suzuki which did not begin production until 1989, to benefit also from the Tariff Exemption.

[17] A note in the Annex to Article 1002.1 of the CUSFTA states that the duty exemption shall cease being granted if, as a result of the acquisition of control over a recipient, "the fundamental nature, scope or size of the business of the recipient is significantly altered". This provision has been reproduced in the MVTO 1998, Schedule, Part 1, para. 4. See footnote 24.

C. The North American Free Trade Agreement (NAFTA)

2.11 The CUSFTA was suspended with the 1 January 1994 entry into force of the NAFTA, an agreement notified to the GATT as an Article XXIV free-trade area involving Canada, Mexico and the United States.

2.12 The NAFTA allows Canada to maintain the import duty exemption subject to the conditions stipulated in the CUSFTA, including those relating to Auto Pact manufacturer eligibility.

2.13 Under the NAFTA, Mexican trucks now enter Canada duty free, while other vehicles are currently subject to duties of 1.3 per cent (passenger cars) and 2.4 per cent (heavy trucks and buses), so long as these products meet the NAFTA origin rules. All such vehicles imported from Mexico will enter duty free after 1 January 2003. Under the NAFTA, all US automotive products meeting NAFTA origin rules have entered Canada duty free since 1 January 1998.

2.14 The European Communities stipulates that, although not themselves in dispute, the CUSFTA and the NAFTA are directly relevant for this dispute.[18] Japan contends that the agreements amplified and exacerbated the discriminatory effects of the measures[19], but it does not include them in its list of measures that it is challenging in this proceeding.[20]

D. Canada's Domestic Measures

2.15 The provisions relating to Auto Pact manufacturers were given effect domestically in Canada through the Motor Vehicles Tariff Order (MVTO) 1965[21], known as the MVTO, and the Tariff Item 950 Regulations [22], which specified the terms under which duty free entry would be permitted. These instruments were replaced by the MVTO 1988[23] and later the MVTO 1998[24], which preserved the essential elements of the earlier legal instruments. The MVTO 1998 is the measure in effect today.

2.16 In line with the Auto Pact provisions allowing Canada to designate additional manufacturers as eligible to import duty free, beginning in 1965 the Government of Canada extended eligibility for the import duty exemption by granting Special Remission Orders (SROs)[25] to individual manufacturers that had not met the original conditions of the MVTO 1965 and its successors.

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18 See para. 5.5.

19 See paras. 5.139 and 5.144.

20 See para. 5.2.

21 P.C. 1965-99, of 16 January 1965 (Exhibit EC-5 and JPN-25).

22 P.C. 1965-100, of 16 January 1965 (Exhibit EC-5).

23 P.C. 1987-2733, of 31 December 1987 (Exhibits JPN-32), amended in P.C. 1988-2872, of 30 December 1988 (Exhibit EC-4).

24 Exhibits EC-3 and JPN-4. The MVTO 1998 is an Order-in-Council passed by the Governor General in Council, on the recommendation of the Minister of Finance. The enabling authority is found in subsections 14 (2) and 16 (2) of Canada's Customs Tariff. The MVTO 1998 is administered by the Minister of National Revenue.

25 Special Remission Orders are regulations adopted under authority of the Financial Administration Act, R.S.C. 1985, c. F-11, s. 23 (Exhibit JPN-3). The MVTO 1965 required companies to have produced motor vehicles in all quarters of the base year, which was defined as the 12-month period from 1 August 1963 to 31 July 1964. Any manufacturer which had not met this requirement was thus effectively prevented from qualifying for the import duty exemption.

2.17 Whereas the Auto Pact calls for Canada to extend to certain manufacturers the right to import duty-free vehicles and original equipment manufacturing parts from the United States[26], the MVTO 1965 accorded the manufacturers the right with respect to "goods imported into Canada on or after 18 January 1965 from any country entitled to the benefit of the British Preferential Tariff or Most-Favoured Nation Tariff…".[27] Similarly, the import duty exemptions provided in the MVTO 1998 and current SROs apply to imports from any country entitled to Canada's MFN rate.

2.18 The MVTO 1998 and current SROs also provide a tariff exemption for the importation of certain parts and components for use as original equipment in the manufacture of motor vehicles. That exemption is not at issue in this dispute.[28]

1. The MVTO 1998

2.19 The MVTO 1998 provides an import duty exemption for the importation of automobiles[29], specified commercial vehicles[30], and buses.[31] (Throughout this Report, the terms "automobile", "specified commercial vehicle" and "bus" are used with the same meaning as in the MVTO 1998, and the term "motor vehicle" is used to designate collectively "automobiles", "specified commercial vehicles" and "buses".)

2.20 The beneficiaries of the MVTO 1998 are the same as the beneficiaries of the Auto Pact, i.e. those manufacturers of a given class of motor vehicles which produced vehicles of that class during each of the four consecutive quarters of the base year.

2.21 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.[32] That Appendix lists a total of 33 firms, of which 4 are identified as manufacturers of automobiles, 7 as manufacturers of buses and 27 as manufacturers of specified commercial vehicles.

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[26] Article II(a) of the Auto Pact.

[27] MVTO 1965, para. 1 (Exhibits EC-5 and JPN-25).

[28] The tariff rate for imports of all original equipment parts was reduced to zero in 1996, irrespective of the status of the importer. See the Memorandum D10-15-21 (Exhibit EC-10).

[29] The MVTO 1998 defines the term "automobile" as "four-wheeled passenger motor vehicle having a seating capacity for not more than 10 persons, but does not include an ambulance or a hearse." It includes headings HS 87.02 or 87.03. Schedule, Part 1, 1(1).

[30] The MVTO 1998 defines the term "specified commercial vehicle" as "a truck, an ambulance or a hearse, or a chassis therefor, but does not include any of the following vehicles or chassis therefor, namely, a bus, an electric trackless trolley bus, a fire truck, an amphibious vehicle, a tracked or a half-tracked vehicle, a golf or invalid cart, a straddle carrier or motor vehicle designed primarily for off-highway use, or any machine or other article to be mounted on or attached to a truck, an ambulance or a hearse or a chassis therefor for purposes other than for loading or unloading the vehicle." It includes headings HS 87.01, 87.03 or 87.05 and chassis therefor of heading HS 87.06. Schedule, Part 1, 1(1).

[31] The MVTO 1998 defines the term "bus" as "a passenger motor vehicle having a seating capacity for more than 10 persons or a chassis therefor, but does not include any of the following vehicles or their chassis, namely, an electric trackless trolley bus, an amphibious vehicle, a tracked or half-tracked vehicle or a motor vehicle designed primarily for off-highway use." It includes heading HS 87.02 and chassis therefor of heading HS 87.06. Schedule, Part 1, 1(1).

[32] Exhibits JPN-7 and EC-9.

2.22 The four manufacturers of automobiles listed in Memorandum D-10-16-3 are Chrysler Canada Ltd.[33], Ford Motor Company of Canada Ltd., General Motors of Canada Ltd., and Volvo (Canada) Ltd.[34]

2.23 The granting of the import duty exemption provided for in the MVTO 1998 is subject to the same type of CVA and ratio requirements as those stipulated in the Auto Pact. Specifically, the schedule to the MVTO 1998 defines a manufacturer as "a manufacturer of a class of vehicles" who:

> "(a) produced vehicles of that class in Canada in each of the four consecutive quarters of the base year; and
>
> (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, and
> >
> > (ii) the Canadian value added is equal to or greater than the Canadian value added in respect of all vehicles of that class produced in Canada by the manufacturer in the base year."

2.24 The requirements are different for each MVTO 1998 beneficiary, depending on its level of CVA, production and sales during the base year.

2.25 A document published by Industry Canada, a department of the Federal Government of Canada,[35] indicates that the ratio requirements applicable to the MVTO 1998 beneficiaries are, "as a general rule", 95 to 100 for automobiles[36], at least 75 to 100 for specified commercial vehicles, and at least 75 to 100 for buses. That same document states that the CVA requirements have been rendered "insignificant" by inflation.

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[33] In May 1998, Daimler-Benz and Chrysler agreed to merge their businesses. DaimlerChrysler Canada Inc. (formerly Chrysler Canada, Ltd.) is now a wholly-owned subsidiary of Daimler Chrysler Corp. (formerly Chrysler Corporation), which in turn is a wholly owned subsidiary of Daimler Chrysler AG, a holding company incorporated in Germany which also controls Daimler-Benz AG. Chrysler Canada Ltd. now imports motor vehicles of the Mercedes brand under the MVTO 1998.

[34] Volvo (Canada) Ltd. ceased the assembly of automobiles in Canada as of December 1998. Accordingly, it has apparently lost the right to import automobiles duty free under the Auto Pact as from 1 August 1999, the next model year. However, Ford Motor Corporation is purchasing the automotive division of Volvo AB and, therefore, can continue to import Volvo automobiles under the Duty Waiver.

[35] "Canada-US Automotive Products Agreement (Auto Pact Background)", Industry Canada, 10 June 1998 (Exhibit EC-20).

[36] Reflecting base-year CVA levels.

2.26 The MVTO 1998 lays down detailed rules for the calculation of the CVA.[37] In accordance with those rules, the cost items to be counted as CVA are, broadly speaking, the following:

- the cost of parts produced in Canada and of materials of Canadian origin that are incorporated in the motor vehicles;
- direct labour costs incurred in Canada;
- manufacturing overheads 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.

2.27 The same rules are applicable for calculating the CVA contained in original equipment parts for motor vehicles.[38]

2.28 The MVTO 1998 requires the beneficiaries to submit, each model year prior to their first importation, a declaration to the Minister of National Revenue, in which they declare that they will comply with the CVA and ratio requirements that model year.[39] The beneficiaries are also to submit to that Minister and to the Minister of Industry "reports that may reasonably be required by those Ministers respecting the production and sale of vehicles by the manufacturer".[40]

2.29 A manufacturer beneficiary not meeting the CVA or ratio requirements stipulated in the MVTO 1998 in any model year as to a class of motor vehicles is liable for the payment of the applicable customs duties on all imports of motor vehicles of that class made during that year. However, only duty-free imports are included in the ratio calculation. Therefore, an importer that is at risk of not meeting its production-to-sales ratio is entitled to start paying duty on any additional imports to be made without having to pay duties on what has already been imported. A manufacturer beneficiary which fails to meet the requirements in any given year does not lose the status of manufacturer beneficiary and may still qualify for the duty exemption in successive model years.

2.30 (For further discussion on administration and enforcement, see Factual Arguments of the Parties, Section V.)

2. Special Remission Orders

2.31 An administrative memorandum of Revenue Canada lists 63 firms as SRO beneficiaries[41] of which 2 are identified as manufacturers of automobiles, 5 as manu-

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37 MVTO 1998, Schedule, Part 1, 1(1), definition of "Canadian Value Added" , letter (a).

38 Ibid., letter (b).

39 Ibid., Part 1, 2 (a). The form of the declaration is set out in MVTO 1998, Schedule, Part 2.

40 Ibid., Part 1, 2 (b). Samples of the reporting documents are provided as Exhibit EC-14.

41 Memorandum D-10-16-2 lists the SROs for every company still manufacturing, but it does not include companies that are still in existence but no longer manufacturing. The orders for those com-

facturers of buses and 59 as manufacturers of specified commercial vehicles. The two manufacturers of automobiles are CAMI Automotive Inc. (a joint venture between Suzuki Motors Corp., of Japan, and General Motors Corp., of the United States) and Intermeccanica International Inc., an artisanal manufacturer of hand-built replicas of famous cars.[42]

2.32 All SROs contain a CVA requirement and a manufacturing requirement (i.e. production-to-sales ratio requirement). The definitions of both requirements under the SROs are the same as the definitions under the MVTO 1998, though the specific levels of CVA and the ratios required vary. Because the SROs were granted after the conclusion of the Canada - US Auto Pact, different base years, or initial periods, were assigned to each SRO beneficiary.

2.33 Regarding CVA requirements, typically the SROs issued before 1984 stipulate that, during an initial period of one to two years, the CVA of the motor vehicles produced in Canada by the beneficiaries should be at least 40 per cent of their cost of production. Thereafter, the CVA should be at least the same (in dollar terms) as in the last 12 months of the initial period. Nevertheless, those SROs provide that if in any subsequent year the cost of production falls below the level of the initial period, the CVA (in dollar terms) could also be less, but in no case less than 40 per cent of the cost of production in that year. In contrast, the SROs issued from 1984 onwards provide, as a general rule, that the CVA of the motor vehicles produced in Canada by the beneficiaries (and in some cases, of the original equipment parts and components) shall be no less than 40 per cent of the cost of sales of the vehicles sold in Canada, with no reference to the values of an initial period. By way of exception, the SRO granted to CAMI[43] prescribes that the CVA of the motor vehicles and original equipment parts produced in Canada by CAMI must represent at least 60 per cent of the cost of sales of the vehicles sold in Canada by CAMI.

2.34 Regarding the production-to-sales ratio requirement, the SROs issued before 1977 set the minimum ratio at 75 to 100. Since then, almost all SROs have a ratio set at 100 to 100. In other words, the sales value of the vehicles produced in Canada by the SRO beneficiaries must be at least equal to the sales value of all the vehicles sold by them in Canada.

2.35 In terms of administration, the SROs lay down reporting obligations similar to those stipulated in the MVTO 1998 (described above), with similar consequences for a company failing to meet the requirements. As with the MVTO 1998, SRO beneficiaries at risk of not meeting their ratio requirements are entitled to start paying duty on any additional imports without having to pay duty on what has already been imported. (See also Factual Arguments of the Parties, Section V.)

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panies remain in force, but they are not in use. (Canada's response to Question 37 from the Panel). See Exhibits EC-8 and JPN-8. Copies of all the SROs listed in the Appendix to the Memorandum appear in Exhibits EC-6 and JPN-6. A table summarising the content of the SROs appears in Exhibit EC-7, and a summary of SRO conditions and evolution over time is contained in Exhibit JPN-28.

42 See Exhibit EC-21.

43 P.C. 1988-2910, of 30 December 1988 (Exhibit JPN-6).

III. FINDINGS AND RECOMMENDATIONS REQUESTED BY THE PARTIES

A. Japan's Request for Findings and Recommendations

3.1 **Japan** requests that the Panel make the following findings and recommendations:

(i) the Duty Waiver[44] is inconsistent with Article I:1 of the GATT 1994 and Articles II and XVII of the GATS;

(ii) the Duty Waiver, by virtue of the domestic content requirement, is inconsistent with Article III:4 of the GATT 1994, Article 2.1 of the TRIMs Agreement, Articles 3.1(b) and 3.2 of the SCM Agreement, and Article XVII of the GATS; and

(iii) the Duty Waiver, by virtue of the manufacturing requirement, is inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement.[45]

3.2 Finally, Japan requests that the Panel recommend that the Government of Canada bring itself into conformity with its obligations under the GATT 1994, the TRIMs Agreement and the GATS. With respect to the inconsistencies with Articles 3.1 and 3.2 of the SCM Agreement, the Government of Japan respectfully requests that the Panel recommend that the Government of Canada withdraw the prohibited subsidy "without delay" in accordance with Article 4.7 of the SCM Agreement.

B. The European Communities' Request for Findings and Recommendations

3.3 The **European Communities** requests that the Panel make the following findings and recommendations:

- the CVA requirements are inconsistent with GATT Article III:4 in that they afford less favourable treatment to imported parts and materials for the manufacture of motor vehicles and parts therefor than to domestic like goods;
- the Ratio requirements are inconsistent with GATT Article III:4 in that they afford less favourable treatment to imported motor vehicles than to domestic like products with respect to their internal sale in Canada;
- the Tariff Exemption[46] is inconsistent with GATT Article I:1 because it provides an advantage to imports of automobiles originating in the

[44] Japan uses the term "Duty Waiver" collectively to refer to the MVTO 1998, the SROs, related statutory and administrative instruments, and the Letters. See also Section V.A.1.

[45] The manufacturing requirement would also be inconsistent with Article III:4 of the GATT 1994 and Article 2.1 of the TRIMs Agreement.

[46] The European Communities uses the term "Tariff Exemption" collectively to refer to (i) the tariff exemption for the importation of motor vehicles, as well as the CVA requirements and production-to-sale "ratio" requirements attached thereto, contained in the Auto Pact, as supplemented by the Letters, and in the MVTO 1998; and (ii) the tariff exemptions for the importation of motor vehicles, and the CVA requirements and "ratio" requirements attached thereto, provided for in the SROs. See also Section V.A.1.

United States and Mexico *vis-à-vis* imports of like products originating in other Members;

- the CVA requirements and the ratio requirements are TRIMs prohibited by Article 2.1 of the Agreement on TRIMs;
- the Tariff Exemption is a subsidy contingent upon export performance as well as upon the use of domestic over imported goods, which is therefore prohibited by Article 3 of the SCM Agreement;
- the CVA requirements are inconsistent with GATS Article XVII because they afford more favourable treatment to Canadian services used in the manufacture of motor vehicles and parts therefor than to like services of other Members; and
- the Tariff Exemption is inconsistent with GATS Article II because it accords more favourable treatment to US suppliers of wholesale trade services for automobiles than to like service suppliers of other Members.

3.4 The European Communities further requests the Panel to find that, by committing the above violations, Canada has nullified and impaired benefits accruing to the European Communities under the cited Agreements.

3.5 The European Communities also requests the Panel to recommend that Canada bring the measures into conformity with its obligations under the GATT, the TRIMs Agreement and the GATS.

3.6 Finally, the European Communities requests the Panel to recommend, pursuant to Article 4.7 of the SCM Agreement, that Canada withdraw the subsidy without delay and to specify in its recommendation the time period within which the subsidy must be withdrawn.

C. Canada's Request for Findings and Recommendations

3.7 **Canada** requests that the Panel make the following findings and recommendations:

3.8 Neither Japan nor the European Communities has demonstrated that the measures at issue violate Canada's WTO obligations. More particularly:

- They have failed to show that the measures violate Article I of the GATT 1994: there is no discrimination against products based on national origin;
- They have failed to show that the measures violate Article III of the GATT: they do not have any effect on the competitive position of imported parts and vehicles in the Canadian market;
- They have failed to show that the measures violate the TRIMS Agreement: the measures are not investment measures, they are not trade-related, they do not violate Article III of the GATT 1994 and in any event they are not included on the Illustrative List;
- They have failed to show that the measures violate the SCM Agreement: they are not a subsidy contingent upon export performance or upon the use of domestic over foreign goods;

- They have failed to show that insofar as the measures accord duty-free treatment they violate the GATS: the measures do not affect services and in any event there is no discrimination against foreign wholesale service suppliers or in favour of service suppliers of certain countries, nor is there any evidence that the companies identified by the claimants compete with each other, or in the case of Article XVII, that Canada has made a relevant commitment; and
- They have failed to show that insofar as the measures contain a CVA requirement they violate Canada's commitments under the GATS: the measures do not discriminate against foreign service suppliers.

3.9 In the light of the foregoing, Canada requests that the claims of Japan and the European Communities be dismissed.

IV. REQUEST FOR PRELIMINARY RULING

A. Japan's Argument Giving Rise to Canada's Request for a Preliminary Ruling

4.1 **Japan** argues as follows:

4.2 Despite the fact that the Government of Japan does not discuss in detail the inconsistency of the manufacturing requirement with Article III:4 of the GATT 1994 or Article 2.1 of the TRIMs Agreement in its arguments to the same extent as was discussed in its Request for the Establishment of a Panel (WT/DS139/2), the Government of Japan reserves its right to elaborate during the course of the panel deliberation on these claims already contained in the said request.

4.3 In discussing how an eligible manufacturer can meet the conditions for the import duty exemption, Japan notes the following:

> "…this manufacturing requirement (the production-to-sales ratio) would be inconsistent with Article III:4 of the GATT 1994, because the manufacturing requirement requires the Auto Pact Manufacturers to increase production of motor vehicles in Canada and this in turn would lead to increased sales of such domestic motor vehicles in the Canadian market beyond the level of sales that would have occurred in the absence of this requirement, thereby upsetting the balance of conditions of competition for sales of like imported motor vehicles. In this regard, the manufacturing requirement would 'affect' the internal sale, purchase or use of products within the meaning of Article III:4 of the GATT 1994."[47]

B. Canada's Request for a Preliminary Ruling

4.4 **Canada** responds as follows:

4.5 Japan purports to reserve the "right to elaborate during the course of the panel deliberation" on its claims regarding the alleged inconsistency of "the manufacturing

[47] See footnote 397.

requirement with Article III:4 of the GATT 1994 or Article 2.1 of the TRIMS Agreement." Canada objects to this reservation and requests this Panel to rule as a preliminary matter that it is not open for Japan or the European Communities to proceed as Japan has proposed to do. As this Panel is well aware, the fundamental tenet of due process requires that the responding party must know the case it is to meet. To permit Japan to develop its claims only when it chooses to do so would necessarily prejudice Canada's ability to defend itself in this action, and would risk offending the basic principle of fairness enshrined in the maxim *audi alteram partem*.[48] WTO panels and the Appellate Body have made it abundantly clear that procedural fairness requires that the complaining party set out its case at the commencement of proceedings and it is not open to it to eke out its claims incrementally during the various stages of the case.[49]

4.6 Prior to its first substantive meeting with the parties, the Panel invited Japan and the European Communities to file a response to Canada's request. Japan responded by reiterating its right to elaborate its claims at a later time; the European Communities did not file a response.

C. The Panel's Decision

4.7 On 14 June 1999 at the first substantive meeting with the parties, the Chairman read out the following decision by the **Panel**:

4.8 The Panel recalls that Japan has stated the following:

> "Despite the fact that the Government of Japan does not discuss in detail the inconsistency of the manufacturing requirement with Article III:4 of the GATT 1994 or Article 2.1 of the TRIMS Agreement in its arguments to the same extent as was discussed in its Request for the Establishment of a Panel (WT/DS139/2), the Government of Japan reserves its right to elaborate during the course of the panel deliberation on these claims already contained in the said request".

4.9 The Panel further recalls Canada's objection to this reservation by Japan and Canada's request to the Panel "to rule as a preliminary matter that it is not open for Japan or the European Communities to proceed as Japan has proposed to do".

4.10 Having carefully considered this matter, including the arguments of each of the parties to the dispute, the Panel has come to the following conclusions:

4.11 First, the Panel does not consider that this is a situation where, as argued by Canada, the complaining party is permitted "to eke out its claims incrementally during the various stages of the case". In making this argument, Canada refers to the Appellate Body decision in *European Communities - Regime for the Importation, Sale and Distribution of Bananas* (EC - *Bananas III)*. However, the situation here is unlike that in *EC - Bananas III*, where the Appellate Body stated that "Article 6.2 of the DSU requires that the *claims*, but not the *arguments*, must all be specified sufficiently in the request for the establishment of a panel in order to allow the defending

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[48] Let the other side be heard.

[49] Appellate Body Report on *European Communities - Regime for the Importation, Sale and Distribution of Bananas*, adopted on 25 September 1997, WT/DS27/AB/R (hereinafter Appellate Body Report on *EC - Bananas III*), DSR 1997:II, 591, paras. 127-128, 143.

party and any third parties to know the legal basis of the complaint" (WT/DS27/AB/R, para. 143). In the case before us there is no Article 6.2 issue of specificity of the measures identified in the panel request. Japan in this dispute has not attempted to reserve a right to present a new claim at a later stage of the proceedings; rather, it appears that Japan has simply indicated that it may wish to further elaborate its arguments as to claims already set out in the panel request and in its initial arguments. As such, the Panel does not consider, at this stage, that Canada is likely to be prejudiced in its ability to defend itself in this action.[50]

4.12 Second, to the extent any issue of procedural fairness should arise, for example, as to the right of rebuttal by Canada should Japan wait until a later stage of these proceedings to develop its arguments as to its GATT Article III:4 and TRIMS Article 2.1 claims with respect to the "manufacturing requirement" (production-to-sales ratio requirement), the Panel will ensure such procedural fairness by providing Canada with adequate opportunity to respond to any such further elaboration by Japan of its arguments under these claims.

4.13 Third, in addition to ensuring procedural fairness, it is of course necessary to set a cut-off date beyond which no new argumentation as to the claims in issue may be accepted, except upon a showing of good cause. In the instant case, the Panel considers that no new argumentation should be introduced beyond the second panel meeting with the parties, except in response to any questions posed by the Panel or otherwise upon a showing of good cause.

V. FACTUAL ARGUMENTS OF THE PARTIES

A. The Measures at Issue

1. Terminology and Clarification of Claims

(a) Japan's Framing of the Measures at Issue

5.1 In setting out the measures at issue, **Japan** indicates the following:

5.2 Canada implements and applies the Duty Waiver through domestic legislation, regulations, statutory instruments, departmental memoranda and administrative practices. More specifically, Canada implements the Duty Waiver pursuant to: (i) section 115 of the Customs Tariff and section 23 of the Financial Administration Act[51]; (ii) the Motor Vehicles Tariff Order, 1998 (MVTO 1998)[52]; (iii) letters of undertaking signed by individual manufacturers upon the demand of the Government of Canada[53]; (iv) Special Remission Orders (SROs) providing for the remission of cus-

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[50] See the Appellate Body Report on *EC - Bananas III*, *supra* note 49, para. 141, where the Appellate Body states that, in its view, "there is a significant difference between the *claims* identified in the request for the establishment of a panel, which establish the panel's terms of reference under Article 7 of the DSU, and the *arguments* supporting those claims, which are set out and progressively clarified in the first written submissions, the rebuttal submissions and the first and second panel meetings with the parties".

[51] Exhibit JPN-3.

[52] Ibid.-4.

[53] Exhibit JPN-5.

toms duties on motor vehicles imported by specified manufacturers[54]; (v) departmental memoranda relating to the MVTO 1998 and the SROs[55]; and (vi) implementing measures taken thereunder. The Government of Canada also exercises administrative discretion regarding certain aspects of the Duty Waiver.[56] In Japan's arguments, the term "Auto Pact Manufacturers" means those companies that are qualified to import motor vehicles duty free under the Duty Waiver MVTO 1998 or its predecessors, or SROs. The term "Non-Auto Pact Manufacturers" mean those companies that are not Auto Pact Manufacturers.

(b) The European Communities' Framing of the Measures at Issue

5.3 In setting out the measures at issue, the **European Communities** indicates the following:

5.4 The measures in dispute are contained in:

- the Agreement Concerning Automotive Products between the Government of Canada and the Government of the United States of America, done at Johnson City on 16 January 1965 (the "Auto Pact")[57];
- the so-called Letters of Undertaking submitted by certain manufacturers of motor vehicles to the Government of Canada in connection with the Auto Pact (the "Letters of Undertaking")[58]:
- the Motor Vehicles Tariff Order, *1998* (the "MVTO 1998")[59];
- the Special Remission Orders providing for a remission of customs duties on imports of motor vehicles issued to certain manufacturers of motor vehicles not covered by the Auto Pact and the MVTO 1998 (the SROs)[60]; and
- the D-Memoranda issued by the Minister of National Revenue for the administration of the above measures, and other implementing measure.[61]

5.5 In addition, although not themselves in dispute, the following are directly relevant for this case:

- the Canada-United States Free Trade Agreement, signed on 2 January 1988 (the CUFSTA)[62]; and
- the North American Free Trade Agreement, signed on 17 December 1992 by the Governments of Canada, Mexico and the United States (the NAFTA).[63]

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54 Ibid.-6.

55 Ibid.-7 and JPN-8. Departmental Memoranda (D-Memoranda) set out the administrative procedures followed by Revenue Canada in the administration of various statutes and regulations.

56 For example, on 3 December 1998, the Government of Canada exercised administrative discretion to grant the remission of MFN duties on imports made by PACCAR Inc. notwithstanding the fact that this eligible importer did not meet the applicable Auto Pact conditions (Exhibit JPN-9).

57 Exhibit EC-1.

58 Ibid. -2.

59 Ibid. -3.

60 Ibid. -6. A Table summarising the requirements of the SROs is provided as Exhibit EC-7.

61 Ibid. -8, -9 and -10.

62 Copies of the relevant provisions are supplied as Exhibit EC-12.

63 Ibid. -13.

5.6 The measures complained of by the European Communities are the following:

- the Tariff Exemption for the importation of motor vehicles, as well as the CVA requirements and production-to-sale "ratio" requirements attached thereto, contained in the Auto Pact, as supplemented by the Letters of Undertaking, and in the MVTO 1998; and
- the Tariff Exemptions for the importation of motor vehicles, and the CVA requirements and "ratio" requirements attached thereto, provided for in the SROs.

5.7 Hereinafter, both types of exemptions will be referred to collectively as the "Tariff Exemption". In turn, the various CVA requirements and ratio requirements attached to the Tariff Exemption will be designated as the "CVA requirements" and the "ratio requirements", respectively. Finally, those manufacturers of motor vehicles which qualify for the Tariff Exemption will be referred to as the "beneficiaries".

(c) Canada's Response to the Complainants' Framing of the Measures At Issue

5.8 With respect to the way the complainants set out the measures at issue, **Canada** responds as follows:

5.9 Both Japan and the European Communities have adopted in their arguments the use of a single term to refer to the measures at issue. Japan refers throughout its arguments to "the Duty Waiver", while the European Communities uses the term "the Tariff Exemption". The Panel is asked to rule that "the Duty Waiver" or "the Tariff Exemption" violates Canada's obligations under the WTO. The complainants' strategy appears to be to combine all manner of items together (be they current measures, repealed provisions, private letters, international agreements, or administrative memoranda) in the hope that this mixture will be enough to constitute a WTO violation. In other words, the complainants recognise that they cannot make out a violation for each of the measures they seek to challenge. So they created a "single" measure, a combination of elements, to try to meet their burden.

5.10 This strategy is misleading and cannot succeed. For there are a number of measures that have been challenged[64], and to succeed in their claims, Japan and the European Communities must prove that each of them is inconsistent with Canada's WTO obligations.

5.11 A ruling on "the Duty Waiver" or "the Tariff Exemption" would have no meaning in law, as neither is a measure subject to challenge under the WTO. In fact, the measures at issue are as follows:

- the Motor Vehicles Tariff Order, 1998 (MVTO 1998)[65]; and
- each of the current Special Remission Orders (SROs).[66]

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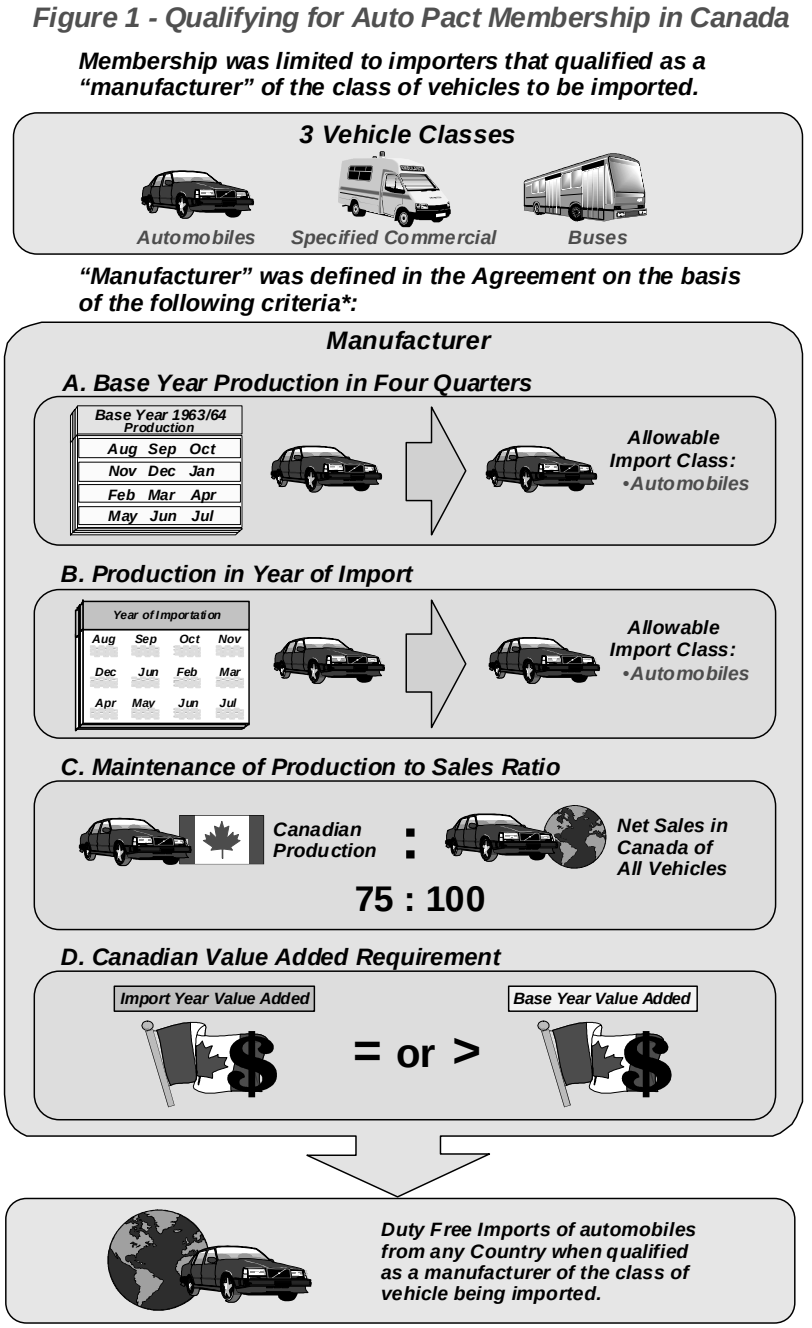
[64] See *Request for the Establishment of a Panel by Japan*, WT/DS/139/2, 13 November 1998; *Request for the Establishment of a Panel by the European Communities*, WT/DS142/2, 14 January 1999.

[65] SOR/98-43 (Exhibits EC-3 and JPN-4).

[66] See Exhibits EC-6 and JPN-6.

5.12 The complainants have also raised other matters, but they cannot properly be described as measures. They include the Auto Pact, Revenue Canada memoranda, letters written in 1965 by certain vehicle manufacturers to the then Canadian Minister of Industry, as well as certain provisions of the CUSFTA and of the NAFTA.

Canada's Figure 1



(d) Japan's Follow-Up to Canada's Response

5.13 Following up on Canada's response to the complainants' framing of the measures at issue, **Japan** adds:

5.14 The Duty Waiver is comprised of a "benefit" in the form of a duty exemption that is contingent on three conditions: (i) an eligibility requirement implemented in the form of an eligibility restriction; (ii) a domestic content requirement implemented in the form of a Canadian value-added (CVA) requirement; and (iii) a manufacturing requirement implemented in the form of a production-to-sales ratio.

5.15 The term "Duty Waiver" is used to simplify the Government of Japan's arguments regarding this series of complex measures.

5.16 It is the position of the Government of Japan that the three classes of instruments (i.e. measures) that implement the Duty Waiver — the MVTO 1998, the letters of undertaking and the SROs—are inconsistent with the obligations of the Government of Canada under the above-noted WTO Agreements. The Government of Japan recognizes that it has the burden to present a *prima facie* case of WTO-inconsistency with respect to the MVTO 1998, the letters of undertaking and the SROs. Given that the characteristics that give rise to the WTO-inconsistencies are identical or very similar in these three classes of instruments, the arguments that apply to the instruments are identical or very similar. To the extent that the arguments differ, the differences have been expressly addressed in the Government of Japan's arguments and are further elaborated upon below.

(e) The EC's Follow-Up to Canada's Response

5.17 Following up on Canada's response to the complainants' framing of the measures at issue, the **European Communities** adds:

5.18 At several points Canada has referred to CAMI as being the only "relevant" SRO beneficiary. In response to a request from the European Communities to clarify those statements, Canada has answered the following:

> " … the EC raised specific allegations only with respect to the Canadian Big Three and Volvo as MVTO beneficiaries and the two SRO automobile manufacturers, namely CAMI Automotive Inc. and Intermeccanica … Canada, as the defending party, is not required to rebut the contents of the EC's Panel request, but only the evidence presented to the Panel …".[67]

5.19 The above assertions are incorrect. The EC's claims under GATT Article I and GATS Article II are limited in scope to imports of automobiles and to the provision of wholesale distribution services for automobiles, respectively. The only SROs concerned by those two claims are the SROs issued to CAMI and Intermeccanica, which are the only two SROs beneficiaries authorised to import automobiles duty free.

5.20 In contrast, the claims submitted by the European Communities under GATT Article III:4 and GATS Article XVII, as well as the EC's claims under the TRIMs

[67] Canada's response to Question 1 from the EC.

Agreement and the SCM Agreement, cover not only the category of "automobiles", but also the other two categories of "motor vehicles", i.e. "buses" and "specified commercial vehicles". Those claims concern *all* the SROs currently in force (a total of 63, according to the list appended to Memorandum D-10-16-2)[68], and not just the SROs issued to CAMI and to Intermeccanica.

5.21 The scope of the EC's claims is stated clearly in the EC's Panel request and in its argumentation. Contrary to Canada's assertions, the European Communities has provided evidence with respect to all the SROs. The European Communities attached a copy of Memorandum D-10-16-2, which contains a complete list of the SROs in force.[69] Furthermore, the European Communities has supplied to the Panel copies of all those SROs[70], as well as a table summarising their contents.[71]

5.22 In response to a question from Japan, Canada has disclosed the name of seven vehicle manufacturers currently utilising SROs to import vehicles other than automobiles.[72] To avoid any possible misunderstanding, the European Communities would like to recall that its claims in this dispute are not limited to those SROs that are currently being "utilised" by their beneficiaries. They cover all SROs in force, whether or not they have been "utilised" recently.

5.23 If an SRO beneficiary which is not currently "utilising" its SRO decided to do so as from the next model year, the Canadian Government would be legally obliged to accord to that beneficiary duty-free treatment, provided that it meets the conditions stipulated in its SRO. Thus, the SROs constitute "mandatory legislation" which, in accordance with settled case law, may be subject to dispute settlement even in those cases where they are not currently being "utilised".[73]

2. Letters

(a) Japan's Arguments Concerning the Letters

5.24 With respect to the Letters (noted above in paras. 2.4 and 2.5), **Japan** argues as follows (with arguments also appearing in Section VI, Legal Arguments of the Parties):

5.25 At the time the Auto Pact was being negotiated, the Government of Canada obtained from a number of Auto Pact Manufacturers additional commitments to meet higher domestic content requirements than specified under the Canada-US Auto Pact. These commitments were set out in company-specific letters of undertaking. Upon the demand of the Government of Canada, General Motors, Ford, Chrysler and American Motors undertook commitments that exceeded those in the MVTO 1965.

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68 Exhibit EC-8.

69 Ibid. -8.

70 Ibid. -6.

71 Ibid. -7.

72 Canada's response to Question 4 from Japan. It is unclear whether, in addition to the seven beneficiaries identified by Canada, there are other beneficiaries which have not given permission to the Canadian Government to disclose their names.

73 See, e.g., the Panel Report on *United States - Taxes on Petroleum and Certain Imported Substances*, adopted on 17 June 1987, BISD 34S/136 (hereinafter Panel Report on *US - Petroleum*), paras. 5.2.1-5.2.2.