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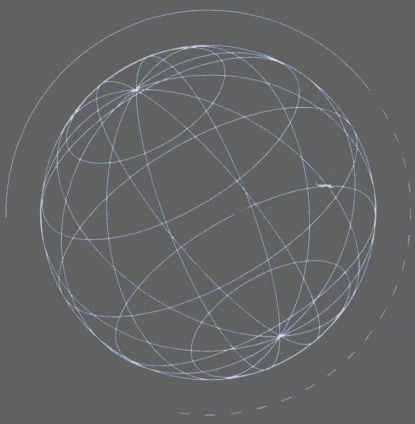

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(6 March 2007)

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D. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. General

Questions to both parties

24. Could the parties explain how they interpret the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the SCM Agreement?

1. The phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the *SCM Agreement* require action that secures the full and complete removal of any adverse effects, or the full withdrawal of any actionable subsidy found to cause adverse effects.

2. As Brazil stated in its answer to Question 22, the terms used in Article 7.8 require *action* by a defending Member, rather than *inaction*, and that removal of the adverse effects or withdrawal of the subsidy must be *complete*, rather than *partial*.

3. Before addressing this interpretive question, Brazil notes a threshold question that must be addressed by a compliance Panel confronted with recommendations under Article 7.8 of the *SCM Agreement* – what is the "subsidy" to be withdrawn, or the adverse effects of which must be removed in the present dispute?

4. In its 26 February response to question 11, Brazil explained that the subsidy subject to the Article 7.8 recommendation includes both the legislative and regulatory subsidy programs in the FSRI Act of 2002 and the price-contingent and mandatory payments made under those programs. In its 26 February response to question 15, Brazil explained that even if the original panel's findings of present serious prejudice were limited to marketing loan and counter-cyclical payments ("CCP") made during a particular historical period (*quod non*), subsequent payments made under the same program are also subject to the United States' implementation obligations. [1]

5. Article 7.8 has two implementation elements set out in the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy", and demonstrates that action, rather than inaction, is required of an implementing Member.

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[1] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 77 ("Some measures with a particularly close relationship to the declared 'measure taken to comply', and *to the recommendations and rulings of the DSB*, may also be susceptible to review by a panel acting under Article 21.5.").

6. The ordinary meaning of the term "take" is "to undertake and perform (a specified function, service, etc.)" or "to perform, make, or do (an act, movement, etc.)".[2] In turn, the ordinary meaning of "step" is "the action, measure, or proceeding, especially one of a series, which leads towards a result."[3] Because the object of the action is "adverse effects", the "appropriate" "steps" must involve action that removes the adverse effects to the interests of another Member.

7. What constitutes the specific "appropriate" steps to take to remove the adverse effects will vary according to the facts of each case. Fundamentally, steps can only be "appropriate" if they achieve full and permanent removal of the adverse effects. For example, the original panel identified the particular *appropriate step* under Article 7.8 that the United States must take regarding the "basket" of price-contingent and mandatory subsidies found to cause present significant price suppression:

> [b]ecause the Panel's "present"' serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted hereunder in MY 2002, *the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice findings. We recall that, pursuant to Article 7.8 of the SCM Agreement, the United States is under an obligation to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy.*[4]

8. At no time did the original panel suggest that an "appropriate step" to remove the adverse effects could involve doing nothing other than waiting for the effects of past payments to dissipate. As Article 7.8 requires action, rather than inaction, to do so would have rendered both Articles 6.3 and 7.8 of the *SCM Agreement* inutile. Any objective reading of the original panel's findings demonstrates that it expected the United States to take action to ensure that present serious prejudice would not continue during the remaining life of the FSRI Act of 2002.[5]

9. The second relevant phrase found in Article 7.8 is "withdraw the subsidy." The structure and placement of the phrase "take appropriate steps," as confirmed by both the French and Spanish versions of the official texts,[6] indicates that it only qualifies and refers to the phrase "remove the adverse effects" – not "withdraw the subsidy."

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[2] New Shorter Oxford English Dictionary, 1993 Edition, Vol. 2, pp. 3207, 3208.

[3] New Shorter Oxford English Dictionary, 1993 Edition, Vol. 2, p. 3050.

[4] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.

[5] Panel Report, *U.S. – Upland Cotton*, paras. 7.1499-7.1503, 8.1(g)(i).

[6] The Spanish text states: "... el Miembro que otorgue o mantenga esa subvención adoptará las medidas apropiadas para eliminar los efectos desfavorables o retirará la subvención." The French text states: "... le Membre qui accorde ou maintient cette subvention prendra des mesures appropriées pour eliminer les effets défavorables ou retirera la subvention."

10. In examining the meaning of the identical phrase "withdraw the subsidy" in Article 4.7 of the *SCM Agreement*, the Appellate Body, in *Brazil – Aircraft (21.5)*, required affirmative action by the defending Member:

> Turning to the ordinary meaning of "withdraw", we observe first that this word has been defined as "remove" or "take away", and as "to take away what has been enjoyed; to take from." This definition suggests that "withdrawal" of a subsidy, under Article 4.7 of the *SCM Agreement*, refers to the "removal" or "taking away" of that subsidy.[7]

11. Given the identity of this aspect of Articles 4.7 and 7.8, the Appellate Body's finding regarding the meaning and action required to "withdraw the subsidy" in Article 4.7 applies also to Article 7.8.

12. A subsidy could be "removed" or "taken away" by the implementing Member enacting new legislation or taking regulatory steps to cease operation or disbursements of payments under the terms of the subsidy measure. As demonstrated above, Article 7.8 requires *affirmative action* to remove the adverse effects or withdraw the subsidy. Inaction is not sufficient.

13. Moreover, *full* removal of the adverse effects or *full* withdrawal of the subsidy is also required. As noted by the Appellate Body, "full withdrawal of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* cannot be achieved by a 'measure taken to comply' that replaces the original subsidy with yet another subsidy found to be prohibited."[8] The same reasoning should apply to Article 7.8. Removing the adverse effects of a subsidy measure or withdrawing a subsidy measure found to cause adverse effects, and subsequently *replacing* it with another subsidy measure that causes adverse effects, is not sufficient.

14. Even assuming, *arguendo*, that the only finding by the original panel was with respect to adverse effects flowing from MY 1999-2002 payments, it is insufficient for the United States to satisfy its obligation to remove the adverse effects or withdraw the subsidy by simply allowing the effects of MY 1999-2002 payments to wane and die a natural death, only to be replaced by even higher price-contingent and mandatory payments during the period MY 2003-2005. Brazil has demonstrated that these "replacement" payments cause similar, if not even greater, significant price suppression in the world market for upland cotton.

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[7] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45 (footnotes omitted).
[8] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 83.

25. How do the parties interpret the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU?

15. Brazil refers the Panel to its answer to Question 24, above, which sets forth the particular characteristics of Article 7.8 of the *SCM Agreement.*

16. Article 7.8 of the *SCM Agreement* is a special and *additional* rule, under Appendix 2 of the DSU. Because there is no conflict between Article 7.8 and Article 21.5 of the DSU, Article 7.8 does not *replace* Article 21.5 in compliance proceedings, but instead *supplements* Article 21.5.

17. An Article 21.5 compliance panel assessing implementation under Article 7.8 plays two, overlapping roles. First, the compliance panel assesses whether an implementing Member has taken affirmative action constituting either appropriate steps to remove the adverse effects, or withdrawal of the subsidy causing those adverse effects. Second, the compliance panel assesses whether any measures taken to comply exist, and if they exist, whether those measures, in their totality[9], are consistent with the covered agreements.

18. As a practical matter, these two assessments can overlap, and may involve the same evidence. But there may be instances in which a Member has, *e.g.*, "withdrawn the subsidy" under Article 7.8 but, nevertheless, *is not* in compliance with Articles 5 and 6 of the *SCM Agreement.* For example, an actionable subsidy found to cause adverse effects may be withdrawn within a period of six months in apparent compliance with Articles 7.8 and 7.9 thereof. However, if the implementing Member later enacts a replacement subsidy of a relatively similar nature, structure, design and operation as the older subsidy, then an Article 21.5 panel would be required to determine (a) whether the replacement subsidy is taken to comply with the recommendations and rulings, and (b) whether this new measure taken to comply – the replacement subsidy – is consistent with the covered agreements and does not cause adverse effects. Such an interpretation is necessary to avoid a Member simply withdrawing one subsidy and replacing it somewhat later with a similar subsidy.

19. In this case, the compliance Panel, under Article 7.8 of the *SCM Agreement* and Article 21.5 of the *DSU*, must first assess Brazil's claim that no measures taken to comply exist with respect to the period 21 September 2005 and 1 August 2006. Second, the compliance Panel must assess whether the United States took action constituting full removal of the adverse effects caused by the basket of three price-contingent and mandatory measures, or fully withdrew those measures. Third, the compliance Panel must determine whether the measure taken to comply, *i.e.*, the limited amendment of the FSRI Act of 2002, is inconsistent with Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement.* In this case, steps two and three above involve the same proof, *i.e.*, that Brazil suffers

[9] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67; Appellate Body Report, *U.S. – Shrimp (21.5)*, para. 87.

serious prejudice by reason of the collective effect of marketing loan and CCP subsidies.

26. Could the parties explain whether they agree or disagree with the arguments of New Zealand in its Third Party Submission that Article 7.8 of the SCM Agreement has certain consequences for the burden of proof in an Article 21.5 proceeding? [Paragraphs 5.04-5.06 of the Third party Submission of New Zealand]

20. Brazil does not agree entirely with New Zealand's "burden of proof" arguments. In the particular circumstances of this case, the original panel found that the "basket" of marketing loan, Step 2, and CCP subsidies caused significant price suppression in the world market for upland cotton. However, the United States repealed one of those three measures – the Step 2 legislation in the FSRI Act of 2002. In view of these particular facts and as set out in Answer to Question 25, Brazil has the burden of demonstrating under Article 7.8 that the United States did not take appropriate steps to remove the adverse effects caused by the original basket of measures. Viewed from the Article 21.5 perspective, Brazil has the burden of demonstrating that the revised FSRI Act of 2002 providing for marketing loan and CCP subsidies and mandatory and price-contingent payments was a measure taken to comply that is inconsistent with Articles 5 and 6.3 of the *SCM Agreement.*

21. Where no changes to the basket of measures found to cause collectively adverse effects have been made, then a complaining member would have the right to proceed immediately to Article 7.9 of the *SCM Agreement* and Article 22.2 of the *DSU*. The rationale for this right is set forth in Brazil's answer to Question 24 above, *i.e.*, that Article 7.8, at a minimum, requires an implementing Member to take *some* action.

22. However, if *arguendo*, a complaining member was required to challenge in an Article 21.5 proceeding the fact that an *unchanged* basket of measures continued to cause significant price suppression, then Brazil agrees with New Zealand that it might be appropriate to permit the complaining Member to establish a *prima facie* case simply by demonstrating the absence of any change in the measures. Further, for the reasons set forth in Brazil's Answer to Question 30, a complaining party would be entitled to rely in an Article 21. 5 proceeding on the prior findings of a panel. This is particularly the case where the same basket of measures found to cause adverse effects continues to exist, unchanged, at the time of the Article 21.5 proceeding.

27. Could the parties comment on the following statement of the European Communities:

"The text of Article 7.8 of the *SCM Agreement* does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Arti-

cle 7.8 of the *SCM Agreement* has to *do* anything" (original emphasis)

23. Brazil disagrees with this assertion of the European Communities for the reasons set forth in Brazil's Answer to Panel Questions 22, 24, and 25.

28. The parties present divergent views with respect to the relevant marketing year to be considered by the panel in its analysis of Brazil's serious prejudice claims.

a) Could the parties explain what they consider to be the relevant legal considerations by which the Panel should be guided in determining whether MY 2005 or MY 2006 is the appropriate marketing year?

24. In assessing the effects of marketing loan and CCP subsidies, the Panel should use the methodological tool of a "reference period."[10] The appropriate reference period is MY 2005, the last recent marketing year for which essentially complete data exists.[11] It may also be appropriate to use partial MY 2006 data where the data has particular indicia of reliability and credibility. However, partial year data should be used with caution because historical data shows that there have been fairly significant shifts of prices, demand, supply based on a number of different factors.

25. The relevant legal considerations for selecting a representative period of time, or a "reference period," to assess the existence of serious prejudice were discussed by the original panel as follows:

> Article 5(c) and 6(c) of the *SCM Agreement* do not refer to any specific time period within which we must conduct our evaluation. ... The Panel concurs with the United States assertion that MY 2002 is a relevant year for our serious prejudice inquiry. It represents a recent period for which essentially complete data exists. The identification of "significant price suppression" flowing from the "effect of the subsidy" calls for an evaluation of this effects-based phenomenon that cannot be conducted in the abstract. Rather, discerning adverse effects of subsidies seems to us to require reference to a recent historical period. We believe, however, that it is important for the establishment of "current" serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time.[12]

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[10] Panel Report, *U.S. – Upland Cotton*, paras. 7.1195-1.1201.
[11] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.
[12] *Ibid.*