Appellate Body Report
European Communities - Export Subsidies on Sugar
(WT/DS265,266,283/AB/R)

Participants
Appellant/Appellee: EC
Appellant/Appellee: Australia, Brazil, Thailand
Third Participants: Barbados, Belize, Canada, China, Colombia, Côte d'Ivoire, Cuba, Fiji, Guyana, India, Jamaica, Kenya, Madagascar, Malawi, Mauritius, New Zealand, Paraguay, Saint Kitts and Nevis, Swaziland, Tanzania, Trinidad and Tobago, U.S.

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Key Findings
• Upheld Panel's findings that complainants acted in good faith, under DSU Article 3.10, "in the initiation and conduct of the present dispute settlement proceedings" and "have not been estopped … from alleging that the [EC's] exports of C sugar are in excess of its export subsidy reduction commitments."

• Upheld Panel's finding that Footnote 1 "does not enlarge or otherwise modify the European Communities' commitment levels as specified in its Schedule."

• Upheld Panel's finding that "the alleged payments in the form of low-priced sales of C beet to sugar producers are 'financed by virtue of governmental action'" under Agriculture Agreement Article 9.1(c).

• Upheld Panel's finding that "the production of C sugar receives a 'payment on the export financed by virtue of governmental action'" under Agriculture Agreement Article 9.1(c), "in the form of transfers of financial resources through cross-subsidization resulting from the operation of the EC sugar regime."

• Upheld Panel's finding that the European Communities acted inconsistently with Agriculture Agreement Articles 3.3 and 8 "by providing export subsidies on sugar in excess of its commitment levels specified in its Schedule."
BACKGROUND

This dispute concerns EC measures related to subsidization of the sugar industry. In 1968, the European Communities established a Common Organization (CMO) for Sugar, the main rules of which are currently set out in "Council Regulation (EC) No. 1260/2001 on the common organization of the markets in the sugar sector" (the "Regulation"), dated June 19, 2001. The Regulation is valid for marketing years 2001/2002 to 2005/2006, and applies, *inter alia*, to cane and beet sugar, sugar beet, sugar cane and isoglucose. The sugar cane and the sugar beet are primarily transformed into raw sugar and/or white sugar.

The Regulation provides the following with regard to the sugar regime. First, it establishes two categories of production quotas: one for "A sugar" and the other for "B sugar." These quotas constitute the maximum quantities eligible for domestic price support and direct export subsidies (or "refunds," as they are called under EC law). The Regulation fixes a basic quota for the entire Community for the production of A and B sugar. The basic quantities for A and B sugar are set, respectively, at 11,894,223.30 tons and 2,587,919.20 tons. Sugar production quotas are allocated to EC member States, who, in turn, allocate a portion of the quota to each processor on the basis of its actual production during a particular reference period. To a limited extent, quotas can be transferred by member States among processors, and processors may carry forward excess production to the next year.

The quota system does not involve any limits on the total quantity of sugar that may be produced or exported. However, sugar produced in excess of A and B quota levels, called C sugar, is not eligible for domestic price support or direct export subsidies and must be exported. Moreover, if proof that the C sugar has been exported is not provided within the required time limits, a charge is levied on that sugar.

Second, the EC Regulation "provides for intervention agencies to buy in sugar," so as "[t]o achieve the objectives of the common agricultural policy and in order to stabilize the EC sugar market." The intervention price applies to the domestic market and also as a guaranteed minimum price to be paid by EC purchasers for imports of sugar from ACP states and India. Similarly, a basic price is established for quota beet and minimum prices are established for A and B beet.

And third, in order to enable export at world market prices, the Regulation provides that the difference between the world market price and the EC price may be covered by "export refunds." The refunds must be the same for all sugar -- except C sugar, which receives no refund -- but may vary according to destination.

As set out in the EC Schedule, in the table in Section II of Part IV, an export subsidy commitment for sugar has been made in the amount of €499.1 million and 1,273,500 tons. A footnote to the sugar entry in the table provides: "Does not include exports of sugar of ACP and Indian origin on which the Community is not making any reduction commitments. The average of export in the period 1986 to 1990 amounted to 1,6 mio t." According to the European Communities' latest notification to the WTO Committee on Agriculture, for marketing year 2001/2002, total exports of sugar amounted to 4,097,000 tons. In addition, the European Communities is required to import 1,294,700 tons (white sugar equivalent) of cane sugar, called "preferential sugar," under Protocol 3 to Annex IV to the ACP/EC Partnership Agreement. It also has agreed to import 10,000 tons of preferential sugar from India. Preferential sugar is imported at zero duty and at guaranteed prices.

(Panel reports, paras. 3.1-16, 7.106-108, 7.244-250)
Before the Panel, the complainants claimed that the European Communities has, since 1995, been exporting quantities of subsidized sugar in excess of its annual commitment levels, contrary to Agriculture Agreement Articles 3 and 8. Specifically, the complainants claimed that the C sugar produced under the EC sugar regime is provided with an export subsidy, within the meaning of Agriculture Agreement Article 9.1(c), and that it is exported in excess of commitment levels, in violation of Agriculture Agreement Articles 3.3 and 8 (in addition, the complainants claimed that these subsidies violate Agriculture Agreement Article 10.1 and SCM Agreement Article 3.1(a), but the Panel invoked judicial economy on these claims). The complainants also contended that the European Communities grants direct export subsidies on the export of "ACP/India equivalent" sugar, within the meaning of Agriculture Agreement Article 9.1(a), in excess of commitment levels, in violation of Agriculture Agreement Articles 3.3 and 8 (in addition, the complainants claimed that these subsidies violate SCM Agreement Article 3.1(a), but the Panel invoked judicial economy on this claim).

The Panel found that the footnote in the EC Schedule related to sugar export subsidy commitments "is of no legal effect and does not enlarge or otherwise modify the [EC] quantity commitment level … ," and concluded that "the Complainants have provided prima facie evidence that since 1995, the European Communities has been exporting sugar in quantities exceeding its commitment level." It also found that the European Communities "has not demonstrated that its exports of ACP/India equivalent sugar are not subsidized," finding instead that these exports receive subsidies within the meaning of Agriculture Agreement Article 9.1(a). As a result, the Panel found violations of Agriculture Agreement Articles 3 and 8. Finally, based on EC exports of "C sugar," it found that all three elements of Agriculture Agreement Article 9.1(c) were met, and that the European Communities "has not demonstrated that exports of C sugar that exceed the … commitment levels since 1995 and in particular since the marketing year 2000/2001, are not subsidized." Consequently, the Panel found a violation of Agriculture Agreement Articles 3 and 8.

On appeal, the European Communities alleged the following errors in respect of the Panel's findings under Article 9.1(c), and also claimed that the Panel erred in relation to its findings that the complainants had acted in good faith and were not estopped from bringing this claim; that the Panel erred in finding that the complainants' Article 9.1(c) claim in relation to below cost C beet sales was within the terms of reference; and that the Panel erred in finding that the violations of Article 9.1(c) resulted in nullification or impairment of benefits. In addition, the complainants filed Notices of Other Appeal, in which they alleged that the Panel erred by exercising judicial economy with respect to the SCM Agreement Article 3 claims.

### SUMMARY OF APPELLATE BODY'S FINDINGS

**PROCEDURAL AND SYSTEMIC ISSUES**

**Amicus Submission**

The Appellate Body received an *amicus curiae* brief from the Association of Central American Sugar Industries (Azucareros del Istmo Centroamericano (AICA)). However, the Appellate Body stated that it "did not find it necessary to take this *amicus curiae* brief into account." (Para. 9)

**Consideration of "New" Arguments**

After noting that the European Communities "did not argue before the Panel that sales of A and B beet are 'largely insufficient to cover all the fixed costs of producing C beet,' in the manner in which it is arguing this point on appeal," the Appellate Body referred to its statement in para. 211 of *Canada -*
Aircraft that "new arguments are not excluded from the scope of appellate review 'simply because they are new.'" It then observed that the European Communities supported its argument with a table containing calculations, and that this table "was not placed before the Panel, but uses data drawn from Exhibits presented to the Panel by the Complaining Parties." The Appellate Body concluded: "We have carefully reviewed the Panel's finding, as well as the European Communities' arguments and supporting calculations, and do not find fault with the Panel's analysis, much less a fault that would justify our interfering with the Panel's appreciation of the evidence." (Paras. 240-243)

**DSU Article 16.4 / DSU Article 17.5 - Extension of Time for Appeal and Circulation of Report**

Australia, Brazil, the European Communities and Thailand informed the Chair of the DSB of a "procedural agreement" concluded between them regarding the 60-day period provided for in DSU Article 16.4 for the adoption or appeal of the Panel reports in this case. Under this agreement, the parties "requested the DSB to postpone the consideration of the Panel Reports and to agree to the extension of the time period … until 31 January 2005." The DSB "took note of these requests and agreed that it would adopt the Panel Reports on or before 31 January 2005, unless the DSB decided by consensus not to do so, or a party notified the DSB of its decision to appeal." An appeal was then filed by the European Communities on January 13, 2005. (Paras. 5-6)

In addition, after consultation with the Appellate Body Secretariat, the European Communities and Australia, Brazil, and Thailand agreed that "it would not be possible for the Appellate Body to circulate its Report in this appeal within the 90-day time limit referred to in Article 17.5 of the DSU." Accordingly, these Members confirmed that "they would deem the Appellate Body Report in this proceeding, issued no later than 28 April 2005, to be an Appellate Body Report circulated pursuant to Article 17.5 of the DSU." (Para. 7)

**Participation of Private Counsel in Oral Hearing - Possible Conflict of Interest**

Mauritius informed the Appellate Body that the ACP Countries were "proposing to retain, for the oral hearing before the Appellate Body, the services of a legal counsel that had also been retained by two associations for European sugar and beet producers." Australia commented that "representation of 'the ACP' in the oral hearing by counsel concurrently engaged by private sector bodies in respect of the same dispute could raise concerns about a perceived or apprehended conflict with the basic principle that appearance and representation before the Appellate Body is limited to Members and their counsel." In response to Australia's comments, Mauritius confirmed "that its legal counsel appearing on its behalf at the hearing 'would be doing so solely as representatives of the WTO Member ACP third participants, and not as representatives of either the ACP (which includes WTO Members who are not participants in this dispute) or of the counsel's other private clients.'" (Para. 11)

**DSU Article 6.2 / Terms of Reference - Sales of C Beet to C Sugar Producers**

The European Communities appealed the Panel's "refusal to dismiss, as falling outside its terms of reference, the Complaining Parties' allegations that C sugar receives 'payments' in the form of low-priced sales of C beet to sugar producers." In this regard, the European Communities contended that "each of the payments alleged by the Complaining Parties 'constituted a different claim,' and, as the panel requests made no mention of the alleged 'payments' in the form of sales of C beet at low prices, this claim fell outside the Panel's terms of reference." (Paras. 131-137)

After setting out its prior jurisprudence in the area of DSU Article 6.2, the Appellate Body reviewed the panel requests in this case. In this regard, the Appellate Body noted the following points: (1) "the panel requests of all the Complaining Parties have clearly identified the 'specific measures at
issue' as the subsidies accorded under EC Regulation 1260/2001 and related instruments ... and the alleged violations as the European Communities' exports of subsidized sugar in excess of the European Communities' commitment levels in contravention of Articles 3 and 8 of the Agreement on Agriculture''; (2) "all three panel requests refer specifically to C sugar and identify as an area of concern the subsidized exports of C sugar in excess of the European Communities' reduction commitment levels"; (3) "all three panel requests clearly explain, although in different terms, that C sugar is being exported at below its total average cost of production and that this occurs due to the subsidies provided under the EC sugar regime for C sugar, which subsidies arise from the profits made by sugar producers on sales of A and B sugar"; and (4) "Brazil's panel request specifically refers to payments in the form of 'high prices paid to growers and processors by the EC sugar regime,' which, in the case of growers, could only mean the high prices provided for A and B beet by the EC sugar regime." In addition, the Panel said, "more importantly for consideration of the issue at hand, all three panel requests specifically allege that the export subsidies provided for C sugar exports violate the obligations of the European Communities under Article 9.1(c) of the Agreement on Agriculture." Thus, the panel requests "clearly draw attention to the allegation of the Complaining Parties that the export subsidies in question for C sugar exports are in the form of 'payments' falling within the meaning of Article 9.1(c) of the Agreement on Agriculture." The Appellate Body noted that while it agreed with the European Communities that "the panel requests did not specifically identify that low-priced sales of C beet by growers to producers was one form of such alleged 'payments,'" it nevertheless considered that "taken as a whole, the panel requests should have informed the European Communities that the Complaining Parties were alleging in their panel requests that C sugar exports below total average cost of production were being enabled by subsidies in the form of 'payments' within the meaning of Article 9.1(c) of the Agreement on Agriculture." Finally, it noted: "C beet being a critical input for C sugar production, and C beet not being eligible for a minimum guaranteed price, unlike A and B beet, the panel requests should have alerted the European Communities that one form of such alleged 'payments' could be low-priced sales of C beet by growers to producers." (Paras. 140-152)

For these reasons, the Appellate Body agreed with the Panel that "the Complaining Parties' panel requests 'complied with the requirements of Article 6.2 of the DSU in that they adequately identified the measures at issue and the violations claimed to have occurred, i.e. that the European Communities' exports of subsidized sugar exceeded the European Communities' commitment level contrary to Articles 3 and 8 of the Agreement on Agriculture.' Therefore, it upheld the Panel's finding that "the alleged 'payments,' within the meaning of Article 9.1(c) of the Agreement on Agriculture, in the form of low-priced sales of C beet to sugar producers, fell within the Panel's terms of reference." (Paras. 155-156)

**DSU Article 3.10 / Estoppel / Good Faith / DSU Article 7.2 / DSU Article 11**

The Panel found that the complainants "ha[d] acted in good faith in the initiation and conduct of the present dispute proceedings," and it emphasized that the complainants "were entitled to initiate the present WTO proceedings as they did and at no point in time have they been estopped, through their actions or silence, from challenging the EC sugar regime which they consider WTO inconsistent." (Para. 302)

The European Communities appealed the Panel's findings "on two grounds." First, it argued that the Panel "failed to address the European Communities' allegation that the Complaining Parties acted inconsistently with Article 3.10 of the DSU 'and, more generally, with the requirements of the principle of good faith.'" Furthermore, "by not addressing that allegation, the Panel 'failed to make an objective assessment of the matter,' as required under Article 11 of the DSU, and 'failed to address the relevant provisions of the covered agreements cited by the parties,' as required by Article 7.2 of the DSU." Second, the European Communities contended that "the Panel erred in finding that the Complaining
Parties were not precluded or estopped from bringing their claims in relation to C sugar." (Para. 303) The Appellate Body considered each issue in turn.

With regard to whether the Panel failed "to address" the EC claims under DSU Article 3.10 and "good faith," the Appellate Body said that the Panel addressed these arguments "together with" the EC arguments regarding "estoppel." The Appellate Body concluded, "it is reasonable for a panel to examine estoppel in the context of determining whether a Member has engaged 'in these procedures in good faith,' as required under Article 3.10 of the DSU," and thus there was "no error" in the Panel's approach. Consequently, the Appellate Body found "no fault with the Panel's analysis under Article 7.2 or Article 11 of the DSU." (Paras. 304-307)

As to whether the complainants were "estopped" from bringing claims against C sugar, the Appellate Body first expressed its agreement with the Panel that "it is far from clear that the estoppel principle applies in the context of WTO dispute settlement." It further noted that this principle "has never been applied by the Appellate Body." Then, it stated that there is "little in the DSU that explicitly limits the rights of WTO Members to bring an action," and said that "even assuming arguendo that the principle of estoppel could apply in the WTO, its application would fall within these narrow parameters set out in the DSU." (Paras. 309-312) In this case, the European Communities argued that the complainants "are estopped from bringing their claims against C sugar because their 'lack of reaction to the non-inclusion of C sugar in the base quantity, together with the other undisputed facts and circumstances ..., clearly represented to the EC that the Complainants shared the understanding that the C sugar regime did not provide export subsidies." On this point, the Appellate Body noted, "the Panel specifically found that 'it is not possible to identify any facts or statements made by the Complainants where they have admitted that the EC measure was WTO consistent or where they have promised that they would not take legal action against the European Communities.'" Furthermore, in response to the EC argument that it "could legitimately rely upon that shared understanding in order not to include exports of C sugar in the base levels," the Panel had "found no evidence of any such 'shared understanding' in this case." On this basis, the Appellate Body rejected the allegation that the complainants were estopped from bringing their claims against C sugar. (Paras. 313-317)

Finally, the European Communities requested the Appellate Body to "rule that, by bringing the claim that exports of C sugar breach the EC's commitments, the Complainants acted inconsistently with Article 3.10 [of the] DSU and, more generally, with the principle of good faith, to the extent that such breach would result from the non-inclusion of C sugar in the base quantity from which the commitments were calculated." The Appellate Body rejected this request, saying that it saw "nothing in the Panel record to suggest that the Complaining Parties acted inconsistently with Article 3.10 of the DSU or the principle of good faith." (Para. 319)

On this basis, the Appellate Body upheld the Panel's findings that "the Complaining Parties acted in good faith, under Article 3.10 of the DSU, in the initiation and conduct of the present dispute settlement proceedings and have not been estopped, through their actions or silence, from alleging that the European Communities' exports of C sugar are in excess of its export subsidy reduction commitments." (Para. 320)

Application of Judicial Economy for SCM Agreement Claims / DSU Article 11

Having found that the European Communities acted inconsistently with Agriculture Agreement Articles 3.3 and 8, the Panel decided to exercise judicial economy with respect to the complainants' claims that "the [EC sugar] regime, or parts thereof, constitute an export subsidy inconsistent with" SCM Agreement Article 3. The complainants claimed on appeal that the Panel "erred in exercising judicial economy," alleging that, in doing so, the Panel acted inconsistently with DSU Article 11. They further
argued that "the Panel erred in exercising judicial economy because it failed to consider the remedies that would have been available to the Complaining Parties under the SCM Agreement, had their claims under Article 3 of that Agreement succeeded." (Paras. 321-324)

In addressing this issue, the Appellate Body first referred to its previous statements on judicial economy in para. 133 of Canada - Wheat and para. 223 of Australia - Salmon, noting that "if a panel fails to make findings on claims where such findings are necessary to resolve the dispute, then this would constitute a false exercise of judicial economy and an error of law" and that "a panel is under a duty 'to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings.'" (Paras. 327-328) The Appellate Body then considered whether the Panel erred in exercising judicial economy here, in particular whether it acted inconsistently with DSU Article 11 by declining to rule on the SCM Agreement Article 3 claims. Noting the different remedies available under DSU Article 19.1 as compared to the special rules in SCM Agreement Article 4.7, the Appellate Body concluded that "the Panel's findings under Articles 3 and 8 of the Agreement on Agriculture were not sufficient to 'fully resolve' the dispute." In this regard, it said that "in declining to rule on the Complaining Parties' claims," the Panel "precluded the possibility of a remedy being made available to the Complaining Parties, pursuant to Article 4.7 of the SCM Agreement, in the event of the Panel finding in favour of the Complaining Parties with respect to [these] claims … ." Moreover, in declining to rule, the Panel "failed to discharge its obligation under Article 11 of the DSU by failing to make 'such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements,' namely, a recommendation or ruling by the DSB pursuant to Article 4.7." This, the Appellate Body said, "constitutes false judicial economy and legal error." (Paras. 329-335)

Having found that the Panel exercised "false judicial economy," the Appellate Body then considered whether it could complete the Panel's legal analysis for the SCM Agreement Article 3 claims. In this regard, the Appellate Body noted the following: the SCM Agreement claims and the Agriculture Agreement claims are not "closely related" because the issues presented are "different in several respects"; the Panel had made reference to the "limited arguments" of the complainants on the SCM Agreement claims; the question of applicability of the SCM Agreement "raises a number of complex issues"; in the absence of a "full exploration of these issues," completing the analysis "might affect the due process rights of the participants"; and finally, it did not have the "requisite factual findings" before it to specify the time period for withdrawal. On this basis, the Appellate Body said that it was "not in a position" to complete the legal analysis, and it therefore declined to do so. (Paras. 336-341)

Working Procedures for Appellate Review Rule 18(5) - Correction of "Typographical Error"

Canada requested "authorization from the Division, pursuant to Rule 18(5) of the Working Procedures, to correct a 'typographical error' in its third participant's submission." Pursuant to Rule 18(5), the Division "invited all participants and third participants to comment on Canada's request." None of the participants objected, and the Division "authorized Canada to correct the error in its third participant's submission." (Para. 10)

Working Procedures for Appellate Review Rule 20(2)(d) - Sufficiency of Notice of Appeal

Australia contended that the European Communities' Notice of Appeal does not satisfy the "due process requirements" of Working Procedures for Appellate Review Rule 20(2)(d) "for four main reasons": (1) the European Communities does not "quote" the "specific Panel findings or conclusions that it appeals"; (2) with respect to some claims, the European Communities "fails to distinguish between a conclusion and a finding, or fails to identify the findings in question"; (3) the European Communities
"does not list, for each claim, the provisions that the Panel is alleged to have erred in interpreting or applying"; and (4) the European Communities "erroneously refers in its Notice of Appeal to a part of its Schedule as 'a provision of a covered agreement.'" On this basis, Australia requested the Appellate Body to "rule whether the EC Notice of Appeal complies with the due process standard for appellate review." (Para. 342)

On this issue, the Appellate Body noted that, in its Notice of Appeal, the European Communities "summarizes the substance of each contested conclusion and the related legal findings and interpretations." Furthermore, the Notice "contains a list of the legal provisions of the covered agreements that the Panel is alleged to have erred in interpreting or applying." Thus, the Appellate Body stated, "the Notice of Appeal gives adequate notice to the Complaining Parties of the content of its appeal so as to allow them to make a proper defence, as required by Rule 20(2)(d) of the Working Procedures." On this basis, the Appellate Body found that the Notice of Appeal "satisfies the requirements of Rule 20(2)(d) of the Working Procedures." (Paras. 344-345)

**SUBSTANTIVE ISSUES**

*Footnote 1 to Section II, Part IV of the EC Schedule - Export Subsidy Commitment Level for Sugar*

The European Communities' export subsidy commitments for sugar, as specified in Section II, Part IV of the EC Schedule, are as follows: (i) the "base quantity level" (the average of the quantity of subsidized exports of sugar during the base period 1986-1990) was 1,612,000 tonnes, and this quantity level would be progressively reduced to 1,273,500 tonnes in the year 2000 as the "final quantity commitment level" for sugar; and (ii) the "base outlay level" (the average of the budgetary outlay on subsidized exports of sugar during the base period 1986-1990) was €779.9 million, and this budgetary outlay level would be progressively reduced to €499.1 million in the year 2000 as the "final [budgetary] outlay commitment level" for sugar. According to the European Communities, these export subsidy commitments are "further elaborated" in Footnote 1 to the European Communities' Schedule, which states:

Does not include exports of sugar of ACP and Indian origin on which the Community is not making any reduction commitments. The average of export in the period 1986 to 1990 amounted to 1,6 mio t.

(Paras. 159-160)

The Panel had found that Footnote 1 "does not indicate" a limitation on export subsidies for sugar to 1.6 million tons. Rather, it found that the footnote is a "unilateral statement" that the European Communities is not making any reduction commitment. Regardless, the Panel said, even if this footnote did constitute a limitation on subsidization, it considered that the footnote conflicts with Agriculture Agreement Articles 3, 8, 9.1 and 9.2(b)(iv), and is "of no legal effect." (Paras. 162-164) On appeal, the European Communities argued that the Panel "erred in its interpretation of Footnote 1 as well as of Articles 3, 8, and 9.1 of the Agreement on Agriculture," and, in the alternative, argued that the Panel's finding is in error because "there is no rule of law giving the Agreement on Agriculture precedence over provisions in a Member's schedule." (Para. 165)

In examining the EC appeal, the Appellate Body considered: the meaning of Footnote 1; the conformity of Footnote 1 with obligations under the Agriculture Agreement; and the relationship between Schedules and the Agriculture Agreement.
Interpretation of Footnote 1

With regard to Footnote 1, the Appellate Body first explained that export subsidy commitment schedules are a part of the GATT, and therefore the treaty interpretation rules in the Vienna Convention on the Law of Treaties apply in interpreting this footnote. (Paras. 166-168)

Applying these rules here, the Appellate Body first examined the "meaning" of Footnote 1. In this regard, the European Communities argued that, "while the budgetary outlay and quantity commitment levels for sugar included in its Schedule constitute the first component of its export subsidy commitment on sugar, Footnote 1 constitutes a distinct second component of its export subsidy commitment on sugar." According to the European Communities, "the first sentence of Footnote 1 means that the European Communities is not making any export subsidy reduction commitments on the export of sugar equivalent in volume to its annual imports of sugar from ACP countries and India"; in turn, "the second sentence of Footnote 1 means that the volume of such exports of sugar will be limited to the lower of its actual imports from ACP countries and India or 1.6 million tonnes." Thus, according to the European Communities, "Footnote 1 provides for an additional subsidized export of up to 1.6 million tonnes of sugar, as well as a separate commitment to 'limit' such subsidization to 1.6 million tonnes or the actual imports of sugar from ACP countries and India, whichever quantity is lower." Furthermore, the European Communities argued that "the words 'exports of sugar of ACP/Indian origin' in the first sentence of Footnote 1 do not mean 're-exports' of sugar of ACP/Indian origin, but mean 'exports' of sugar by the European Communities 'corresponding' to its imports of sugar from ACP countries and India." (Para. 169)

In addressing this issue, the Appellate Body first said that a "plain reading" of Footnote 1 does not indicate that it involves an EC commitment to "limit" subsidization of "exports of sugar of ACP and Indian origin." (Para. 174)

The Appellate Body then considered specific aspects of the terms of Footnote 1, in their context and in light of its object and purpose. It began with the phrase "sugar of ACP and Indian origin" in the first sentence. In this regard, it turned to the question of whether, as argued by the European Communities, "the first sentence of Footnote 1, interpreted in its context, shows that it 'was intended to cover equivalent exports,' that is, exports of sugar equivalent in volume to the European Communities' imports of ACP and Indian sugar." The Appellate Body said that it was "not persuaded" by the EC arguments, which, it explained, "rely on the presumed knowledge of other [WTO] Members … on the export subsidy practices of the European Communities with respect to ACP/India sugar." In any event, it noted, "the European Communities' submissions do not alter the plain meaning of the first sentence of Footnote 1, so as to make it cover the exports of sugar equivalent in volume to the European Communities' imports of sugar from ACP countries and India." (Paras. 175-180)

Next, the Appellate Body considered whether, as argued by the European Communities, the second sentence of Footnote 1, in its context, "contains a commitment on the part of the European Communities to 'limit' its subsidization of exports of sugar to the lower of its imports from ACP countries and India or 1.6 million tonnes." (Paras. 181-185) On this point, the Appellate Body said that it was "not convinced" by the EC arguments, and it saw "merit in the Panel's reference to the notification practice of the European Communities to the WTO Committee on Agriculture to conclude that this practice does not support the interpretation advanced by the European Communities." On this basis, the Appellate Body found that Footnote 1, both by its terms and taking into account the EC arguments, "does not contain a commitment on the part of the European Communities to 'limit' its subsidization of exports of sugar to a quantity equivalent to its actual imports of sugar from ACP countries and India or 1.6 million tonnes, whichever is lower." (Paras. 186-188)

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The Appellate Body then examined the "conformity" of Footnote 1 with the Agriculture Agreement (based on the assumption, for the sake of argument, that Footnote 1 does contain an export subsidy commitment to "limit" export subsidies based on ACP/India "equivalent" sugar, as argued by the European Communities.) (Para. 189) In this regard, the Appellate Body considered the conformity of the footnote with both Agriculture Agreement Article 3.3 and Article 9.1.

With regard to Article 3.3, the European Communities asserted that "Article 3.3 does not require a Member to schedule both budgetary outlay and quantity commitments in respect of export subsidies listed in Article 9.1." Rather, either one or the other, or both, could be scheduled. Thus, "[t]he obligation in Article 3.3 is only to provide Article 9.1-listed subsidies in conformity with whatever commitments are found in a Member's schedule," Therefore, the European Communities argued, Footnote 1 is in conformity with this provision. The Appellate Body rejected this argument, noting that the reference in Article 3.3 to "budgetary outlay and quantity commitment levels" suggests that the drafters intended that both types of commitments must be specified. As support, the Appellate Body referred to, inter alia, Article 9.2(b)(iv) and 9.2(a). (Paras. 190-199) Thus, the Appellate Body agreed with the Panel that "Article 3.3 requires a Member to schedule both budgetary outlay and quantity commitment levels in respect of export subsidies listed in Article 9.1 … ." Because Footnote 1 "does not contain a budgetary outlay commitment in respect of export subsidies provided to ACP/India equivalent sugar," the Appellate Body held "that it is inconsistent with Article 3.3." (Para. 200)

As to Article 9.1, the European Communities asserted, inter alia, that "[t]he normative content of Article 9.1 ... is not to impose reductions, but to define the scope of those subsidies which are permitted within commitment levels." On this point, the Appellate Body noted that the Article 9.1 chapeau states that the listed subsidies "are subject to reduction commitments under this Agreement." It noted that the export subsidies provided to ACP/India equivalent sugar fall under Article 9.1(a), and are therefore subjection to reduction commitments. Furthermore, it said that Article 9.2(b)(iv) lends "contextual support to the view that export subsidies listed in Article 9.1 are subject to reduction commitments." Examining Footnote 1, it observed that it "explicitly states that the European Communities is not making 'any reduction commitments' in respect of ACP/India sugar ... ." Moreover, the European Communities has not "reached the prescribed commitment levels, both in terms of budgetary outlays and quantity ... ." Thus, it concluded, Footnote 1 is inconsistent with Article 9.1. (Paras. 203-210)

Finally, the Appellate Body considered the "relationship" between Members' Schedules and the Agriculture Agreement, in particular, whether the claimed commitment in Footnote 1 "limiting" subsidization of exports of sugar "can prevail over the provisions of the Agreement on Agriculture, despite such a commitment being inconsistent with Articles 3.3 and 9.1 of the Agreement on Agriculture." (Para. 211) On this issue, the Appellate Body said "[i]t is clear from the plain wording of Article 8 that Members are prohibited from providing export subsidies otherwise than in conformity with the Agreement on Agriculture and the commitments as specified in their Schedules." Thus, "compliance with both is obligatory." As compliance with the provisions of the Agriculture Agreement is obligatory, "it is clear that the commitments specified in a Member's Schedule must be in conformity with the provisions of the Agreement" because "[o]nly then would the export subsidies be in compliance with the requirements of Article 8." (Para. 216) In addition, the Appellate Body rejected the EC argument that the Panel erred in relying on the findings of the GATT panel in U.S. - Sugar, finding instead that, similar to the Sugar case, here there is "no provision under the Agreement on Agriculture that authorizes Members to depart, in their Schedules, from their obligations under that Agreement." Thus, it "[saw] no basis for the European Communities' assertion that it could depart from the obligations under the Agreement on Agriculture through the claimed commitment provided in Footnote 1." (Paras. 217-220) Finally, the Appellate Body noted that Footnote 1, as part of the EC Schedule, "is an integral part of the GATT," by
virtue of Agriculture Agreement Article 3.1. Therefore, pursuant to Agriculture Agreement Article 21, the provisions of the Agriculture Agreement "prevail over Footnote 1." (Para. 222)

For the above reasons, the Appellate Body found that, "even assuming that Footnote 1 constitutes a 'commitment' expressing a limitation on export subsidization of ACP/India equivalent sugar, Footnote 1 does not contain both quantity and budgetary commitments and is, therefore, inconsistent with Article 3.3 of the Agreement on Agriculture"; and, it held, "Footnote 1 is inconsistent with Article 9.1 of the Agreement on Agriculture, because exports of ACP/India equivalent sugar are not subject to reduction commitments." Furthermore, because Footnote 1 is inconsistent with Articles 3.3 and 9.1, it is also inconsistent with Article 8. However, the Appellate Body said that it did not agree with the Panel that Footnote 1 "is of no legal effect," although it did agree with the Panel that "Footnote 1 does not have the legal effect of enlarging or otherwise modifying the European Communities' commitment levels as specified in its Schedule." (Paras. 224-225)

On this basis, the Appellate Body upheld the Panel's finding that Footnote 1 "does not enlarge or otherwise modify the European Communities' commitment levels as specified in its Schedule." (Para. 226)

**Agriculture Agreement Article 9.1(c) - "Payments"**

Before the Panel, the complainants claimed that the EC sugar regime involved various types of "payments on the export of an agricultural product that are financed by virtue of governmental action" within the meaning of Agriculture Agreement Article 9.1(c). The Panel examined two of these types of alleged "payments" and found (1) that "C sugar producers receive payment on export by virtue of governmental action through sales of C beet below the total costs of production to C sugar producers"; and (2) that "producers/exporters of C sugar ... receive payments on export by virtue of governmental action ... in the form of transfers of financial resources, through cross-subsidization resulting from the operation of the EC sugar regime." Thus, the Panel found that both types of "payments" it examined are "payments on the export ... financed by virtue of governmental action," within the meaning of Agriculture Agreement Article 9.1(c), and that, therefore, they constitute export subsidies under Article 9.1. Furthermore, the Panel concluded that the European Communities had not demonstrated, pursuant to Agriculture Agreement Article 10.3, that exports of C sugar exceeding the European Communities' commitment levels since 1995 are not subsidized. On appeal, the European Communities alleged that certain aspects of the Panel's findings with respect to these two alleged export subsidies were in error. (Paras. 227-229)

The Appellate Body first examined the Panel's finding that the sales of C beet by beet growers to C sugar producers constitute an export subsidy within the meaning of Article 9.1(c), and it then examined whether the alleged "cross-subsidization" constitutes an export subsidy within the meaning of that provision.

**Payments in the form of below cost C beet sales to C sugar producers/exporters**

The Panel made three findings in reaching its conclusion that sales of C beet by beet growers to sugar producers/exporters constitute an export subsidy under Agriculture Agreement Article 9.1(c): (1) that sales of C beet involved "payments" because C beet was being sold at prices below its average total cost of production; (2) that these payments were "on the export"; and (3) that these "payments" were "financed by virtue of governmental action." With regard to this third finding, the Panel found that this element was satisfied due to a "demonstrable link" and "clear nexus" between the financing of the payments and governmental action, in that the European Communities "controls virtually every aspect of domestic beet and sugar supply and management" and this "controlling governmental action" is
"indispensable" to "the transfer of resources from consumers and tax payers to sugar producers and, through them, to A and B beet growers." (Paras. 230-231)

The European Communities appealed the third Panel finding, that is, that "payments" in the form of sales of C beet are "financed by virtue of governmental action." Specifically, the European Communities argued that the Panel "applied a test whereby the phrase 'financed by virtue of governmental action' will be satisfied where governmental action merely 'enable[s] the beet growers to finance and make payments.'" The European Communities also argued that the Panel "incorrectly assumed that beet growers 'finance' the sales of C beet by profits from sales of A and B beet and that governmental action in the European Communities' beet market is 'less pervasive' than in Canada – Dairy." Finally, the European Communities contended that the Panel "disregarded certain 'other factors' that affect the supply and prices of C beet, but do not involve governmental action." (Paras. 230-232)

Article 9.1(c) sets forth the following type of export subsidy: "payments on the export of an agricultural product that are financed by virtue of governmental action ... ." In considering this provision, the Appellate Body referred to its reports in Canada - Dairy, Canada - Dairy, Article 21.5 and Canada - Dairy, Article 21.5 II, where it interpreted each of the elements of "financed by virtue of governmental action," as follows: Article 9.1(c) "does not place any qualifications on the types of 'governmental action' that may be relevant under that provision," and "governmental action need not involve a government 'mandate' or other 'direction';" "financed," it said, refers to the "mechanism" or "process" by which financial resources are provided, such that payments are made, but "the government itself need not provide the resources for producers to make payments," as payments "may be made and funded by private parties"; finally, "by virtue of" means that there must be a "nexus" or "demonstrable link" between "the governmental action at issue and the financing of payments," although "significant aspects of the financing might not involve government." (Paras. 233-237)

Turning to the facts of this case, the Appellate Body noted that the Panel "relied on a number of aspects of the EC sugar regime" in reaching its finding: "the EC sugar regime regulates prices of A and B beet and establishes a framework for the contractual relationships between beet growers and sugar producers with a view to ensuring a stable and adequate income for beet growers; C beet is invariably produced together with A and B beet in one single line of production; a significant percentage of beet growers are likely to finance sales of C beet below the total cost of production as a result of participation in the domestic market by making 'highly remunerative' sales of A and B beet; the European Communities 'controls virtually every aspect of domestic beet and sugar supply and management,' including through financial penalties imposed on sugar producers that divert C sugar into the domestic market; the European Communities' Sugar Management Committee 'overviews, supervises and protects the [European Communities'] domestic sugar through, inter alia, supply management'; the growing of C beet is not 'incidental,' but rather an 'integral' part of the governmental regulation of the sugar market; and C sugar producers 'have incentives to produce C sugar so as to maintain their share of the A and B quotas,' while C beet growers 'have an incentive to supply as much as is requested by C sugar producers with a view to receiving the high prices for A and B beet and their allocated amount of ... C beet.'" The Appellate Body then said that it agreed with the Panel that, "in the circumstances of the present case, all of these aspects of the EC sugar regime have a direct bearing on whether below-cost sales of C beet are financed by virtue of governmental action." It therefore rejected the EC appeal argument that the Panel applied a test relying on the mere "enabling" by the government of financing. (Paras. 238-239)

In addition, with respect to the EC argument that the Panel incorrectly "assumed" that a "significant" percentage of beet growers are "likely to finance sales of C beet below the costs of production as a result of participation in the domestic market in selling high priced A and B beet," the Appellate Body said that it had reviewed the Panel's findings and found no fault with the Panel's analysis. (Paras. 240-243) The Appellate Body also rejected EC arguments that the "governmental action" here is
"less pervasive" than that in *Canada - Dairy, Article 21.5 II*, and that the Panel "disregarded or improperly dismissed 'other factors' that affect the supply and prices of C beet, but that do not involve governmental action." (Paras. 244-249)

**On this basis, the Appellate Body upheld the Panel's finding that "the alleged payments in the form of low-priced sales of C beet to sugar producers are 'financed by virtue of governmental action,'" within the meaning of Agriculture Agreement Article 9.1(c).** (Para. 250)

*Payments in the form of cross-subsidization resulting from the profits made on sales of A and B sugar*

The Panel found that "cross-subsidization," "in the form of transfers of financial resources from the high revenues resulting from sales of A and B sugar, for the export production of C sugar," constitutes an export subsidy within the meaning of Agriculture Agreement Article 9.1(c). The European Communities argued on appeal that this finding of the Panel is in error because: (i) "cross-subsidization" does not constitute a "payment," as it does not involve a "transfer of resources" to the sugar producers; and (ii) the alleged "payment" is not made "on the export" of C sugar, because the sugar producers are not required to produce or export C sugar. In addition, the European Communities argued that "the Panel acted inconsistently with Article 11 of the DSU by making a finding with respect to a claim that the Complaining Parties 'neither made nor argued.'" (Paras. 253-254)

In addressing these issues, the Appellate Body first examined whether "cross-subsidization" constitutes a "payment" within the meaning of Article 9.1(c) and, second, it examined whether any such payment is "on the export of an agricultural product" within the meaning of that provision. It then considered the European Communities' claim with respect to DSU Article 11.

**Whether "Cross-Subsidization" Constitutes a "Payment"**

In finding that "cross-subsidization" constitutes a "payment," the Panel addressed a number of factors: "C sugar was sold on the world market at prices 'well under' the average total cost of production every year from 1992/1993 to 2002/2003"; "the price charged for C sugar does not even remotely cover its cost of production"; and "to the extent that the fixed costs of A, B and C [sugar production] are largely paid for by the profits made on sales of A and B sugar, the EC sugar regime provides the advantage which allows EC sugar producers to produce and export C sugar at below total cost of production." Thus, the Panel concluded that there was a "payment" "in the form of transfers of financial resources from the high revenues resulting from sales of A and B sugar, for the export production of C sugar, within the meaning of Article 9.1(c) of the *Agreement on Agriculture.*" (Para. 257)

On appeal, the European Communities made several arguments that the Panel's finding was in error. First, the European Communities argued that the alleged "cross-subsidization" is "an internal allocation of each sugar producer's own resources" and therefore not a "transfer of resources." The Appellate Body rejected this argument, noting, *inter alia*, that a "payment" does not necessarily require the "presence of two distinct entities." (Paras. 261-267) In addition, the European Communities argued that the alleged "cross-subsidization" provides no benefit to the sugar producers. On this point, the Appellate Body observed that Article 9.1(c) does not require an "independent enquiry into the existence of 'benefit.'" (Paras. 268-269)

**On this basis, the Appellate Body upheld the Panel's finding that, "in the particular circumstances of this dispute, the production of C sugar receives a 'payment on the export financed by virtue of governmental action,' within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, in the form of transfers of financial resources through cross-subsidization resulting from the operation of the EC sugar regime."** (Para. 270)
Whether any such "Payment" is "On the Export"

The Panel concluded that the "payment" in the form of "cross-subsidization" was a payment "on the export" of C sugar within the meaning of Article 9.1(c) because C sugar, "unless carried forward, must be exported." The Panel further stated that "[b]ecause of that legal requirement, advantages, payments or subsidies to C sugar, that must be exported, are subsidies 'on the export' of that product." On appeal, the European Communities argued that "the Panel misinterpreted the requirement that a payment be 'on the export' of an agricultural product, as contained in Article 9.1(c)," arguing that this term must be read as meaning "contingent on" exports, rather than "in connection with" or to the "advantage" of exports. (Paras. 272-273)

On this point, the Appellate Body noted that in relation to "below-cost sales of C beet," the Panel stated that "payments" "on the export" need not be "contingent on" the export but, rather, must be "in connection" with exports. By contrast, under its "cross-subsidization" analysis, the Panel "did not use the same reasoning," but rather stated that "[b]ecause of [the] legal requirement [that C sugar be sold for export], advantages, payments or subsidies to C sugar, that must be exported, are subsidies 'on the export' of that product." The Appellate Body said that it agreed with the Panel's view, noting that C sugar "must be exported," and that payments in the form of "cross-subsidization" are, therefore, "payments" "on the export." (Paras. 274-275)

On this basis, the Appellate Body upheld the Panel's finding that "the payment on C sugar production in the form of [a] transfer of financial resources through cross-subsidization resulting from the operation of the EC sugar regime is on [the] export within the meaning of Article 9.1(c) of the Agreement on Agriculture." (Para. 278)

Finally, the Appellate Body rejected the European Communities' allegations that "the Panel's finding blurs the distinction between domestic support and export subsidies," and that "by upholding the Panel's finding, our interpretation of Article 9.1(c) would turn this provision into 'a prohibition of low priced exports.'" (Paras. 258, 281, 283)

DSU Article 11

The European Communities argued that the Panel acted inconsistently with DSU Article 11 because it erroneously "attributed to the Complainants the allegation that 'cross-subsidization' was a type of 'payment,'" and "[b]y making a finding with respect to a claim which the Complainants had never articulated …." On this point, the Appellate Body noted that it had already upheld the Panel's finding that the complainants' "argumentation that C sugar receives advantages from various subsidies and payments, within the meaning of Article 9.1(c), is within the Panel's terms of reference." In addition, citing para. 156 of its decision in EC - Hormones, the Appellate Body concluded that "the Panel did not act inconsistently with Article 11 of the DSU by developing its own reasoning as to why the EC sugar regime gives rise to export subsidies within the meaning of Article 9.1(c)." (Paras. 284-286)

Cost of Production of C Sugar

Finally, the Appellate Body rejected the EC arguments that, "in ascertaining the existence of 'payments,' the Panel erred in using as a benchmark the average total cost of production of all sugar" rather than the "average total cost of producing C sugar," and that the Panel "effectively double counted the subsidies allegedly granted upon the exports of C sugar." (Paras. 287-289)
Conclusion

On this basis, the Appellate Body upheld the Panel's finding that the European Communities acted inconsistently with Agriculture Agreement Articles 3.3 and 8 "by providing export subsidies on sugar in excess of its commitment levels specified in its Schedule." (Para. 290)

DSU Article 3.8 - Presumption of Nullification or Impairment

As explained by the Appellate Body, pursuant to DSU Article 3.8, "where a Member has acted inconsistently with a covered agreement, the inconsistency is presumed to nullify or impair benefits accruing to other Members." Article 3.8, it noted, "equates the concept of 'nullification or impairment' with 'adverse impact on other Members.'" In this case, the Appellate Body said, the Panel found that the European Communities acted inconsistently with the Agriculture Agreement "by providing export subsidies on sugar in excess of its commitment levels," and that it failed to rebut the presumption, pursuant to Article 3.8, that this inconsistency had an adverse impact. On appeal, the European Communities argued that "until recently, the Complainants shared the EC's understanding that the C sugar regime does not provide export subsidies." Therefore, the complainants "had no expectations of improved competitive opportunities that would come from the EC reducing its exports of C sugar." (Paras. 293-296)

In addressing this issue, the Appellate Body first noted that instead of trying to rebut the complainants' evidence of trade losses, the European Communities "appears to suggest that, to rebut the presumption of nullification or impairment, it need only demonstrate that the Complaining Parties 'could not have expected that the EC would take any measure to reduce its exports of C sugar.'" However, the Appellate Body said that based on Article 3.8, "unless a Member demonstrates that there are no adverse trade effects arising as a consequence of WTO-inconsistent export subsidies, we do not believe that a complaining Member's expectations would have a bearing on a finding pursuant to Article 3.8 of the DSU." Therefore, it concluded, the European Communities "has failed to rebut the presumption of nullification or impairment pursuant to Article 3.8 of the DSU." (Paras. 298-299)

On this basis, the Appellate Body upheld the Panel's finding that the European Communities' violations of the Agriculture Agreement nullified or impaired the benefits accruing to the complainants under this agreement. (Para. 300)

COMMENTARY

Agriculture Agreement Article 9.1(c) - "Blurring" the Line between Export Subsidies and Domestic Support

The European Communities expressed a concern that upholding the Panel's finding that the payments at issue are "on the export" within the meaning of Article 9.1(c) would lead to "blur[ring] the distinction between the disciplines on domestic support and on export subsidies, which is an essential feature of the Agreement on Agriculture" and would "allow ... virtually any form of domestic support" to be "characterize[d] as an 'export subsidy.'" Canada, as a third participant, also stated that the Panel's approach to the term "on the export" would mean "exposing 'bona fide' domestic support to challenge." (See para. 279)

The Appellate Body rejected this argument, explaining that "the European Communities' legislation requires the exportation of C sugar, and prices obtained for C sugar on the world market are
significantly below the average total cost of production of sugar in the European Communities." Thus, it said, "we do not consider that our interpretation erodes the boundary between 'domestic support' and 'export subsidies' recognized under the Agreement on Agriculture," but rather it "respects the boundary between the two and operates to ensure that Members provide domestic support and export subsidies in conformity with their obligations under the Agreement on Agriculture." (See paras. 281-282)

The Appellate Body's explanations on this issue could help to define the scope of its jurisprudence on Article 9.1(c) more clearly. In its earlier rulings on this provision in Canada - Dairy, Article 21.5 and Canada - Dairy, Article 21.5 II, the Appellate Body arguably created a fairly broad standard, as there was no explicit statement, like the one here, about the importance of a requirement to export under the measures at issue. As a result, the Appellate Body's findings there could have been interpreted very broadly to mean that the mere existence of domestic agricultural support combined with below-cost export sales would result in a finding that export subsidies existed. See DSC for Canada - Dairy, Article 21.5 (AB). Here, by contrast, the Appellate Body emphasized that its findings of violation were based in part on the formal requirement that C sugar be exported. Thus, it could be argued that the Appellate Body's finding here narrows the scope of its earlier rulings by requiring a close tie between the subsidy and export in order to find a violation of Article 9.1(c), and thus reduces the potential for "blurring" the line between export subsidies and domestic support.

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