Panel Reports

European Communities - Export Subsidies on Sugar
(WT/DS265/R, WT/DS266/R, WT/DS283/R)

Parties

**Complainants**: Australia, Brazil, Thailand  
**Respondent**: EC  
**Third Parties**: Australia, Barbados, Belize, Brazil, Canada, China, Colombia, Côte d’Ivoire, Cuba, Fiji, Guyana, India, Jamaica, Kenya, Madagascar, Malawi, Mauritius, New Zealand, Paraguay, Saint Kitts and Nevis, Swaziland, Tanzania, Thailand, Trinidad and Tobago, U.S.

Panelists

Mr. Warren Lavorel (Chairperson),  
Mr. Gonzalo Biggs, Mr. Naoshi Hirose

Timeline of Dispute

**Panel Requests**: EC  
(Australia), (Brazil), (Thailand): July 9, 2003  
**Panel Established**: August 29, 2003  
**Panel Composed**: December 23, 2003  
**Interim Reports Issued**: August 4, 2004  
**Final Reports Issued to Parties**: September 8, 2004  
**Final Reports Circulated**:  
(Australia), (Brazil), (Thailand): October 15, 2004  
**Notice of Appeal**: January 13, 2005  
**Notices of Other Appeal**:  
(Australia), (Brazil), (Thailand): January 25, 2005  
**AB Report Circulated**: April 28, 2005  
**Adoption**: May 19, 2005

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**Key Findings**

- Found that a 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 … ."  
  **[Appellate Body upheld finding that the footnote does not enlarge or modify the commitment.]**  
  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."

- Based on EC exports of "C sugar," 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, found a violation of Agriculture Agreement Articles 3 and 8.  
  **[Appellate Body upheld Panel's findings of violation.]**

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Key Findings Continued on Next Page.
Key Findings Continued

- Concluded that the European Communities "has not demonstrated that its exports of ACP/India equivalent sugar are not subsidized," finding that these exports receive subsidies within the meaning of Agriculture Agreement Article 9.1(a). As a result, found a violation of Agriculture Agreement Articles 3 and 8.

Note on Multiple Panel Reports in this Case:

In this case, complaints were brought by Australia, Brazil and Thailand, and the Panel issued separate reports related to each of the three complaints. Because the three Panel Reports are identical, we have produced one Commentary covering all three reports.

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. (Paras. 3.1-16, 7.106-108, 7.244-250)

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 claimed 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).

**SUMMARY OF PANEL'S FINDINGS**

**PROCEDURAL AND SYSTEMIC ISSUES**

**DSU Article 9.2 - Separate Panel Reports**

At the request of the European Communities, pursuant to DSU Article 9.2, the Panel issued three reports for this dispute, one for each of the three complainants in the dispute. (Para. 1.13)

**Notification of Third Parties' Interest in Participating in Panel Proceedings**

The Panel was established on August 29, 2003. Both Kenya, on September 26, 2003, and Côte d'Ivoire, on November 5, 2003, later requested to participate in the panel process as third parties. These requests were made "after the ten-day notification period specified by the Chairman of the DSB at the time of the establishment of the Panel, but before the Director-General was asked by the parties to compose the Panel pursuant to Article 8.7 of the DSU." As explained by the Panel, the "parties agreed to accept Kenya as a third party but the Complainants objected to the participation of Côte d'Ivoire." (Para. 2.1)

In addressing this issue, the Panel first noted that DSU Article 10 "is silent on when Members need to notify to the DSB their interest in participating in any specific dispute as third parties." Rather, the relevant legal provision is the GATT Council Chairman's Statement of June 1994 (GATT Council C/COM/3), which provides for a ten-day notification period. (Para. 2.2) The Panel then recalled the Appellate Body's statement in footnote 138 of **EC - Hormones** that "the DSU leaves panels a margin of
discretion to deal, always in accordance with due process, with specific situations that may arise in a particular case and that are not explicitly regulated." In addition, it said, with regard to the two requests at issue in this particular dispute: "(a) the selection and composition of the Panel did not appear to have been adversely affected; and (b) the Panel process had not been hampered." On this basis, the Panel therefore decided, in a preliminary ruling, "to accept as third parties all Members that had expressed a third-party interest and saw no reason to treat them differently." In doing so, "the Panel emphasized that its decision was specific to this dispute and was not intended to offer a legal interpretation of the ten-day notification period referred to in the GATT Council Chairman's Statement." (Paras. 2.3-4)

**DSU Article 10 - Enhanced Third Party Rights**

The Panel noted that, prior to "starting [its] work," Mauritius, on behalf of 14 ACP sugar producing countries, requested that the Panel provide the ACP countries with "extended third-party rights." In a preliminary ruling, it said that in light of "the importance of trade in sugar for many third parties," the Panel decided to grant additional rights to all third parties, as follows: "to attend the entirety of the first substantive meeting as observers; to make a written submission to the Panel and receive the submissions of the parties and third parties for that meeting; and to present their views orally at a session of that meeting, set aside for that purpose." Additional rights were also granted for the remaining panel proceedings: "(a) the third parties will receive a copy of the written questions to the parties posed in the context of the first substantive meeting of the Panel; (b) the third parties will receive the written rebuttals of the parties to the second meeting of the Panel and the parties' replies to the questions mentioned … above; (c) the third parties may attend the second substantive meeting of the Panel to take place on 11 and 12 May 2004, as observers (but it is not envisaged that the third parties will provide any further written submission or make an oral statement to the Panel during that second meeting); and (d) the third parties will review the summary of their respective arguments in the draft descriptive part of the Panel report." Later, Guyana, on behalf of the ACP sugar producing countries, requested certain additional rights for third parties at the second substantive panel meeting. However, the Panel ruled that no further rights would be granted above those previously stated. (Paras. 2.5-9)

**Additional Procedures for Protection of Confidential Information**

On January 13, 2004, Australia and Thailand requested that the Panel adopt additional working procedures for the protection of certain proprietary information relating to data on EC costs of sugar production. Such additional working procedures would, *inter alia*, "limit the third parties' access to such confidential information to 'view-only' prescriptions." The European Communities opposed this request. In a preliminary ruling, the Panel rejected the request, noting that existing DSU provisions requiring confidentiality were sufficient. (Paras. 2.10-19)

**Timing of Objections to the Panel's Jurisdiction**

The European Communities did not request any preliminary rulings, as provided for in the Panel's Working Procedures, in relation to the Panel's jurisdiction under its terms of reference. However, it did raise concerns on this issue in its written submissions and at the Panel meetings, which, Australia noted, was "some six months after the Panel was established and more than two months after the Panel was composed." (Para. 7.5) On this issue, the Panel first noted that "WTO jurisprudence is clear that parties should bring alleged procedural deficiencies to the attention of the other party and the Panel at the earliest possible opportunity." However, the Panel also said that certain issues relating to the "jurisdiction" of a panel "can be raised at any time and even by the panel itself." (Paras. 7.6-9) Here, the Panel was not convinced "that the European Communities raised all its objections at the earliest possible time," but because some of these objections "are concerned with the jurisdiction of this Panel," they may be viewed "as so fundamental that they could be considered at any stage of the Panel proceeding." On this basis,
"with the view to ensuring clarity in the Panel's terms of reference and the security of this panel process," the Panel decided to consider the issues of the Panel's jurisdiction raised by the European Communities. (See next section) ( Paras. 7.10-11)

**Terms of Reference / DSU Article 6.2**

**Identification of "Payments" as Distinct Measures or Distinct Claims**

The European Communities argued that the complainants did not properly identify the measures that allegedly violated Agriculture Agreement Articles 3.3 and 8, because the measures were not the "export of sugar" as such, but rather "the export subsidies granted by the European Communities." According to the European Communities, the complainants should have identified "the specific measures of the European Communities' sugar regime which … provided the alleged export subsidies applied by the European Communities in order to circumvent its reduction commitment." By contrast, the European Communities argued, "a simple reference to the European Communities' 'sugar regime' or to Council Regulation No. 1260/2001 (which comprises of 51 articles, 6 annexes, and covers 45 pages of the Official Journal of the European Communities)" was not sufficiently "specific." Moreover, "exports of sugar" is a private transaction, not a government "measure" within the meaning of DSU Article 6.2, "and thus could not be the subject of dispute settlement." (Para. 7.18)

Reviewing the text of the complainants' panel requests, the Panel concluded that these requests meet the requirements of DSU Article 6.2, "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." In this regard, the Panel noted that "a claim under Article 3 of the Agreement on Agriculture requires allegations that, first, the European Communities has exported sugar above its commitment level and, second, that such exports of sugar were subsidized." Noting the difference between "claims" and "arguments," the Panel stated that the requests "sufficiently informed the European Communities what measures the Complainants were challenging and what violations were claimed." On this basis, the Panel concluded that the allegations under Article 9.1(c) related to "various subsidies and payments" for C sugar are within the terms of reference. (Paras. 7.24-37) (On appeal, the Appellate Body upheld the Panel's findings related to the specific aspects of the finding appealed by the European Communities. See [DSC for EC - Sugar Subsidies (AB)].)

**Identification of Claims under Agriculture Agreement Article 9.2(b)(iv)**

The European Communities contended that Agriculture Agreement Article 9.2(b)(iv) was not mentioned in the complainants' panel requests, nor in their first written submissions, and therefore this provision "could not form the basis for a finding of inconsistency with any other provision" of the Agriculture Agreement. The Panel rejected this argument, noting that the complainants made reference to this provision in the context of the parties' arguments relating to the identification of the commitment levels. Recalling the distinction between "claims and arguments" established in WTO jurisprudence, the Panel stated that the complainants were entitled to develop arguments related to their claims under Article 3, as was the case here with the Article 9.2(b)(iv) argument. In doing so, it rejected the EC suggestion that "an appropriate test" for distinguishing "'claims from 'arguments' would be to anticipate what would be the consequences of upholding a given 'argument,'" such that "[i]f upholding a purported 'argument' leads to establishing a violation of a legal provision, but does not render unnecessary the examination of another purported 'argument' made under the same legal provision, it is because each of the two 'arguments' involve a distinct 'claim.'" The Panel concluded, "the European Communities' allegation that the Complainants' arguments and references to Article 9.2(b)(iv) are outside the Panel's terms of reference is thus not founded." (Paras. 7.38-44)
Identification of Claims in Relation to Footnote 1 to the EC Schedule

In its first submission, the European Communities argued that the complainants "had made subsidiary claims that the European Communities was not respecting the terms of Footnote 1 to its Schedule," and the European Communities considered that these claims "were not sufficiently identified [in the panel requests]." (Para. 7.45) In addressing this issue, the Panel stated that the European Communities is using footnote 1 "as a rebuttal argument" to the complainants' claims under Agriculture Agreement Articles 3 and 8. When the European Communities made reference to the footnote, the complainants "had the right to challenge such arguments as well as the scope of the European Communities' commitment." On this basis, the Panel found that the complainants' arguments with respect to commitment levels, including those on footnote 1, are within the terms of reference. (Paras. 7.45-53)

EC Allegation that Complainants are "Estopped" from Pursuing this Dispute

The European Communities argued that the violations alleged by the complainants "would have been flagrant and immediately manifest upon the conclusion of the WTO Agreement," yet none of the complainants raised any question with respect to exports of C sugar and issues relating to the ACP/India sugar footnote "until this dispute." According to the European Communities, "the Complainants' silence may be legitimately construed as a representation of lack of objections not only where there is a 'duty to speak,' but also in circumstances where it is reasonable to expect that the other parties will speak." Here, because "it was reasonable to expect that Members would not challenge the fact that [the European Communities] did not include the additional subsidies of the ACP/India sugar Footnote and C sugar in its base quantity," the European Communities submitted that the complainants "are estopped from bringing this claim" on the basis of what it considered to be its "good faith expectations." (Paras. 7.54-57)

In addressing this issue, the Panel noted "it is far from clear whether the principle of estoppel is applicable to disputes between WTO Members in relation to their WTO rights and obligations," and it observed that "[e]stoppel is not mentioned in the DSU or anywhere in the WTO Agreement." (Para. 7.63) It then stated, "[g]iven the 'largely self-regulating' nature of the requirement in the first sentence of [DSU] Article 3.7, panels and the Appellate Body must presume, whenever a Member submits a request for establishment of a panel, that such a Member does so in good faith, having duly exercised its judgement as to whether or not recourse to that panel would be 'fruitful.'" (Paras. 7.66-67) Finally, it recalled the statement by the GATT panel in EEC - Import Restrictions that: "... it would be erroneous to interpret the fact that a measure had not been subject to Article XXIII over a number of years, as tantamount to its tacit acceptance by contracting parties ... ." (Para. 7.68)

The Panel then stated, DSU Article 3.7 "neither requires nor authorizes a panel to look behind that Member's decision or to question its exercise of judgement (unless there is evidence of bad faith)." Thus, it said, "[u]nder WTO jurisprudence, the fact that a Member does not complain about a measure at a given point in time, cannot by itself deprive that Member of its right to initiate a dispute at some later point in time if that Member considers in good faith that it is fruitful to do so." (Para. 7.69)

Even assuming arguendo that estoppel could be invoked, the Panel considered that "the present situation is not one for which estoppel could find application." In this regard, it recalled the requirements for the application of the principle of estoppel as set out in prior WTO cases: "[T]he essential elements of estoppel are: (i) a statement of fact which is clear and unambiguous; (ii) this statement must be voluntary, unconditional, and authorized; (iii) there must be reliance in good faith upon the statement ... to the advantage of the party making the statement"; and "estoppel is premised on the view that where one party has been induced to act in reliance on the assurances of another party, in such a way that it would be prejudiced were the other party later to change its position, such a change in position is
'estopped', that is precluded." Based on these explanations of estoppel, the Panel said that "Brazil's and Thailand's silence concerning the European Communities' base quantity levels as well as with respect to the ACP/India sugar Footnote does not amount to a clear and unambiguous representation upon which the European Communities could rely, especially considering that, in the Panel's view, there was no legal duty upon the Complainants to alert the European Communities to its alleged violations." According to the Panel, the "silence" of some of the complainants "cannot be equated with their consent to the European Communities' violations, if any." (Paras. 7.70-73) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

Amicus Submission / Breach of Confidentiality in Relation to Amicus Submission

The Panel received an "unsolicited amicus curiae brief" from Wirtschaftliche Vereinigung Zucker ("WVZ"), an association representing German sugar producers. (Para. 2.20) Following the recommendation of the Appellate Body in U.S. - Shrimp, and "with a view to ensuring due process," the Panel invited the parties to make comments on the submission. The complainants requested in their comments "that the Panel reject the document submitted by WVZ on the grounds of inaccuracy of the facts and analysis advanced by WVZ, late timing of the document and due process considerations, and they further contended that this submission addressed issues that have already been argued at length by the parties." In a later communication, Brazil claimed "that there was evidence that a breach of confidentiality had occurred" with respect to certain information provided in the amicus submission. (Paras. 7.76-79)

In addressing this issue, the Panel first noted that the WVZ submission was filed "almost two weeks after the Panel's second meeting with the parties," and the Panel considered "that the timing of the amicus curiae submission plays an important role in the acceptance or rejection of amicus curiae briefs." (Para. 7.81) The Panel then decided "not to consider further the amicus curiae from WVZ because, inter alia, it is based on confidential information [in one of Brazil's submissions] and is thus evidence of a breach of confidentiality which disqualifies the credibility of the authors." In response to a question from the Panel, WVZ "acknowledged that it 'was able to examine' Brazil's exhibit but refused to provide the source of its information." The Panel considered that if the WVZ "wanted to be considered a 'friend of the court,' it should have followed an appropriate standard of behaviour towards the Panel and the parties together with making every possible effort to respect WTO dispute settlement rules, including confidentiality rules." On this basis, the Panel, "having the discretionary legal authority to accept and consider or not unsolicited amicus curiae briefs submitted by individuals or organizations, whether governmental or non-governmental," declined to consider further the amicus submission. (Paras. 7.80-85)

The Panel further addressed the breach of confidentiality issue related to the amicus submission, as follows. Brazil informed the Panel that the amicus submission "disclosed information that Brazil had submitted to the Panel in confidence," and, accordingly, Brazil "wished to bring the alleged breach of confidentiality to the Panel's attention and requested that the Panel 'investigate how the breach occurred' and that it take any further action that it deems appropriate, including 'mak[ing] a full report of this incident to the Dispute Settlement Body.'" (Paras. 2.21, 2.28, 7.86) In response, the Panel invited comments from the parties and third parties on this issue, and requested information from the WVZ on the sources of data referred to in its submission. WVZ submitted a response in which it indicated that "it had been able to examine an attachment to Brazil's submission," but that WVZ was "not in a position to reveal the source of its information regarding the evidence submitted by Brazil." (Paras. 2.24-27, 7.87-92)

The Panel recalled that DSU Article 18.2 "provides explicitly that Members must respect the confidentiality of any information designated as such by another Member in the context of the settlement of a dispute"; that the complainants "had explicitly designated the said LMC Report as confidential"; and
that "on a number of occasions throughout the proceedings of this Panel it strongly emphasized and reminded parties and third parties of the confidential nature of the DSU proceedings." Based on the facts here, the Panel concluded that "a breach of confidentiality did occur in the framework of these proceedings." While it "used its best endeavours to investigate the alleged breach of confidentiality," it was not "able to determine the source of the breach." Finally, the Panel said that it "hereby reports the incident to the Dispute Settlement Body." (Paras. 7.95-99)

**Agriculture Agreement Article 10.3 - Burden of Proof**

As explained by the Panel, Agriculture Agreement Article 10.3 reverses the normal rule of burden of proof, such that "once the Complainants have factually proven that the European Communities is exporting sugar in quantities exceeding its commitment levels, there is a shift in the burden of proof and it is then for the European Communities to prove that the sugar it exports in quantities exceeding its commitment level is 'not' subsidized." The Panel noted the European Communities' argument that "the Complainants would impose an impossible task of identifying all the conceivable export subsidies that it does not grant." However, the Panel said, "this is not the European Communities' task." Instead, it explained, "the European Communities must provide prima facie evidence that excess exports of sugar are not subsidized." In this regard, a respondent should be able to make a demonstration that the measure "is not caught by one or other of the definitions in Article 9.1(a) to (f) of the Agreement on Agriculture" and should also be able to demonstrate that the measure "is not a 'subsidy contingent upon export performance' within the meaning of Article 1(e) of the Agreement on Agriculture." (Paras. 7.223-229)

Applying Article 10.3 here, the Panel discussed both the "quantitative aspect" and the "subsidization aspects" of the claim. In terms of quantities exported, the Panel said that "the Complainants have provided prima facie evidence that since 1995, the European Communities has been exporting sugar in quantities exceeding its commitment level." In this regard, it noted, "while the European Communities' export subsidies commitment level was for 1,273,500 tonnes of sugar for the 2000/2001 marketing year, its actual sugar exports amounted to 4,097,000 tonnes, that is some 2,823,500 tonnes in excess of its commitment level." (Para. 7.230) Having reached this conclusion, the Panel placed the burden of proof on the European Communities and then examined the EC arguments that its excess exports of sugar are not subsidized. (Para. 7.231)

**SUBSTANTIVE ISSUES**

**The European Communities' Export Subsidy Commitment Levels for Sugar**

The European Communities' quantity commitment levels for subsidized exports of sugar are set out in Section II of Part IV of the EC Schedule CXL as "1,273,500 tonnes" for the year 2000 and thereafter. In addition, footnote 1 is inscribed after the term "sugar," and 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." (Paras. 7.106-108)

The complainants claimed that, in every marketing year since 1995, the European Communities' total exports of sugar have "consistently exceeded" its scheduled commitment levels. For example, during the marketing year 2001-2002, the European Communities exported 4,097,000 tons of sugar, whereas the scheduled commitment level was only 1,273,500 tons. In response, the European Communities argued that its level of reduction commitment is not 1,273,500 tons only; rather, footnote 1 operates as "a ceiling, or limitation on subsidization, and a limited authorization to provide export subsidies," allowing an additional amount of subsidized exports that is "equivalent" to the 1,600,000 tons of ACP/Indian origin sugar referred to in the footnote. Consequently, using these figures, the European
Communities submitted that it has provided subsidies in conformity with the Agriculture Agreement and with the commitments as specified in its Schedule. (Paras. 7.109-111) On this point, the complainants argued that under GATT/WTO jurisprudence, WTO Members could incorporate in their Schedules "only acts yielding rights, not acts diminishing obligations," and therefore the footnote is "legally invalid." (Para. 7.114)

In examining the European Communities' commitment level for exports of subsidized sugar, the Panel said it would need "to assess whether it is possible to interpret harmoniously the terms of the Agreement on Agriculture together with those of Footnote 1 of Section II, Part IV of the European Communities' Schedule." To assess whether there is a conflict, the Panel would first determine "the extent and the scope of Members' obligations" under Agriculture Agreement Articles 3, 8 and 9; second, it would examine "what Members are entitled to do in their Schedules and how terms of Members' Schedules should be interpreted"; third, it would examine "the nature of the commitment, if any, included in Footnote 1"; and finally, it would "discuss the relationship between the European Communities' obligations under Articles 3, 8 and 9 of the Agreement on Agriculture and Footnote 1 with a view to assessing whether the two sets of rights and obligations can be read harmoniously or whether they conflict." (Para. 7.122)

The Agriculture Agreement Obligations on Export Subsidies under Articles 3, 8 and 9

The Panel began its analysis by interpreting the Agriculture Agreement obligations relating to export subsidies. In this regard, it noted that the term "commitment levels" is not defined in Articles 3, 8 and 9. Thus, it turned to the context of these provisions for guidance. Reviewing various provisions of the Agriculture Agreement that it considered relevant in this regard, the Panel concluded that Articles 3 and 8 make clear that Members may not provide export subsidies "other than in conformity" with the Agriculture Agreement and the reduction commitments in the Schedules. To comply with Article 3.3, it said, "a Member that exports a scheduled product must comply with two distinct requirements: (1) its subsidized exports must be within the quantity limitation specified in its schedule; and (2) its corresponding budgetary outlays must also be within its commitments." Furthermore, the Panel considered that "Article 3.3 (and Article 9.2(b)(iv)) makes it clear that the level of commitment of export subsidies on specified products must be scheduled both in terms of quantity and in terms of budgetary outlays, as the level of reduction of any such export subsidies apply to both their quantity and to their budgetary outlays: 'a Member shall not provide export subsidies … in excess of the budgetary outlay and quantity commitment levels specified [in its Schedule].'" (Paras. 7.124-137)

The European Communities disagreed with this conclusion, arguing that "export subsidies do not have to be expressed both in terms of budgetary outlays and quantity," and it submitted what it alleged to be departures from this principle in other Members' Schedules. However, the Panel noted, inter alia, that if a Schedule "did not specify both of these limitations," a Member "could export a subsidized scheduled product in excess of its commitment level and remain in compliance with Article 3.3 of the Agreement on Agriculture, because the challenging Member will be unable to demonstrate that the European Communities' exports do not exceed either of the two limitations." Moreover, the Panel disagreed that the examples from the other Schedules exhibited departures from the requirement. (Paras. 7.138-141)

On this basis, the Panel concluded that the Agriculture Agreement "makes it clear that export subsidies are only possible for products listed in Section II, Part IV of Members' Schedules and only for amounts at or below the maximum level of commitment provided for in a Member's Schedule." Moreover, it said, "all WTO-consistent export subsidies must have been specified in a Member's Schedule, both in terms of quantity and in terms of budgetary outlays and all WTO-consistent export subsidies on scheduled products must have been subject to reduction commitments during the
implementation period." (Para. 7.143) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

Interpretation of Schedules

The Panel then addressed the interpretation of terms in a Member's Schedule. Specifically, it examined whether the European Communities' commitment level with respect to export subsidies on sugar "can legally include two components: the first component being the commitment levels expressed in the table on export subsidies (which have decreased during the implementation period of the Agreement on Agriculture and has remained fixed since 2001); the second component being the commitment levels expressed in Footnote 1 to the EC's Schedule in respect of ACP/India sugar." (Paras. 7.144-145)

The Panel explained that provisions in a Member's Schedule should be interpreted as treaty provisions, as the scheduled commitments are "made an integral part of the GATT 1994" under Agriculture Agreement Article 3.1. In this regard, it noted that the "primary purpose" of treaty interpretation is to identify the "common intention" of the parties, and under the principle of "effective treaty interpretation" all terms "must be given a meaning." Thus, the Panel considered that, in the interpretation of footnote 1, "it must use its best endeavours to give due meaning to the said Footnote and respect the principle of effective treaty interpretation." (Paras. 7.146-154)

Issue of Conflict

The Panel next turned to the issue of "conflict" between provisions of a Member's Schedule and provisions of the Agriculture Agreement. In this regard, the Panel recalled the presumption against conflicts in international law, and noted that this principle has been recognized in WTO jurisprudence in the context of "internal conflicts" within the WTO Agreement, including Members' Schedules. Under this jurisprudence, a conflict exists only when two provisions are "mutually exclusive." In terms of the relationship between WTO Agreement provisions and Members' Schedules, the jurisprudence further provides that Members may use entries in their Schedules to "clarify and qualify" the concessions they have agreed to, but not to "reduce or conflict" with the obligations they have assumed. (Paras. 7.155-161) With this in mind, and recalling the Appellate Body ruling that it is "the duty of any treaty interpreter to 'read all applicable provisions of a treaty in a way that gives meaning to all of them, harmoniously,'" the Panel said it would examine "whether the content of Footnote 1 of the EC's Schedule on the one hand, and the European Communities' obligations pursuant to Articles 3, 8 and 9 of the Agreement on Agriculture on the other hand, can be read 'harmoniously' or whether the content of Footnote 1 – being inconsistent and conflicting with the European Communities' basic obligations under the Agreement on Agriculture – should be considered without any legal effect and would thus not enlarge or otherwise modify the commitment level specified in Section II, Part IV of the European Communities' Schedule." (Para. 7.165)

Interpretation of Footnote 1

With these principles in mind, the Panel interpreted footnote 1, which is inscribed after the term "sugar" and 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." The Panel noted the following EC arguments as to the meaning of this footnote:

Both sentences of the footnote are relevant in order to fully understand the EC's commitments. The footnote is numbered (1) and is found next to the term 'sugar' in the column entitled "description of products", thus applying to the full entry. The first sentence has two elements to it.
First, it confirms that exports of an equivalent amount of ACP/Indian sugar were not included in the quantities and outlays reported by the EC for the base period level (1986-1990) which served as a basis for the figures set out in the table. … The second element of the first sentence makes it clear that exports of the quantity of ACP/India sugar imported shall not be counted against the commitments made on the base period levels (this is the logical concomitant of the non-inclusion of these exports in the base period).

…

Therefore, according to a proper interpretation of the footnote the EC has articulated its subsidy commitments in two components. One component sets limits which are subject to reduction, and the second component (the footnote) sets a fixed ceiling. Overall, the EC has reduced its export subsidies on sugar.

(Paras. 7.167-168) Thus, according to the European Communities, its commitment is the following: there is a general commitment not to export more than 1,273,500 tons of subsidized sugar. However, this commitment level does not include the 1,600,000 tons of sugar imported from the ACP/India. Referring to this amount, the European Communities argued that it may export up to 1,600,000 tons of subsidized sugar, that is, an amount "equivalent" to the amount of ACP/India imports, and this amount is outside of its general commitment.

The Panel rejected the EC argument, as follows. First, it said, the ordinary meaning of the terms of the footnote does not indicate any "limitation on export subsidies for sugar" to 1.6 million tons, and thus there is no commitment "limiting subsidization." Furthermore, it observed that the EC notifications to the Committee on Agriculture "do not suggest that Footnote 1 constitutes a limitation on subsidization." (Paras. 7.169-174) In addition, referring to the Agriculture Agreement Article 18 review process, the Panel noted that the European Communities "has not reported the amounts of actual subsidized quantities and budgetary outlays corresponding to exports of sugar of ACP and Indian origin." Therefore, in the Panel's view, the European Communities' "notification practice" "suggests that the European Communities has not assumed a commitment to limit subsidization of sugar of ACP or Indian origin," which "implies that the European Communities itself has not 'treated' the Footnote as a commitment specified in its Schedule." (Paras. 7.175-177) Rather, the terms of the footnote "indicate that the European Communities is making a statement that exports of subsidized sugar of ACP/Indian origin will not be subject to the reduction commitments provided for in Articles 3, 9.1 and 9.2(b)(iv) of the Agreement on Agriculture." Furthermore, the Panel considered that "the ordinary meaning of the terms of Footnote 1 does not provide that an amount of subsidized sugar 'equivalent' to the amount of sugar imported from ACP/India will be maintained for export." Rather, it said, the footnote "appears to require that the sugar exports excluded from export reduction commitments actually be sugar of ACP and Indian origin, as stated in Footnote 1." (Paras. 7.178-180, 7.183)

Therefore, the Panel concluded that the ordinary meaning of footnote 1 "does not authorize an additional 1.6 million tonnes of subsidized sugar to be exported corresponding or equivalent to the amount of imports from ACP and India," and it "does not enlarge or otherwise modify the European Communities' quantity commitment level specified in Section II, Part IV of its Schedule to be 1,273,500 tonnes of sugar per year, or its budgetary outlay commitment of €499.1 million per year, with effect since marketing year 2000/2001." (Para. 7.184)
Before stating its final conclusion, the Panel considered several other issues. First, it examined whether the footnote could be regarded as a second component of the European Communities' commitment level that would not be subject to reduction *per se*, but would form part of the overall European Communities' commitment level. In this regard, the Panel recalled that "the possibility of maintaining export subsidies is an exception to the general prohibition against export subsidies" contained in Agriculture Agreement Article 8, and that "WTO-consistent export subsidies that could be maintained if and when scheduled, had to be subject to reduction commitments." (Paras. 7.185-187) Here, because the Panel considered that footnote 1 "attempts to reduce and modify the European Communities' obligation pursuant to Articles 3, 8, 9.1 and 9.2(b)(iv) of the Agreement on Agriculture," it "is fundamentally inconsistent with the basic provisions of the Agreement on Agriculture …." Therefore, it said, "the content of Footnote 1 contradicts and conflicts with the European Communities' basic obligations contained in Articles 9.1, 9.2(b)(iv), 3 and 8 of the Agreement on Agriculture," and "it is not possible to interpret harmoniously Footnote 1 and the European Communities' basic obligations relating to export subsidies contained in the Agreement on Agriculture." As a result, the Panel found that "the content of Footnote 1 is of no legal effect and does not enlarge or otherwise modify the European Communities' quantity commitment level specified in Section II, Part IV of its Schedule to be 1,273,500 tonnes of sugar per year, or its budgetary outlay commitment of €499.1 million per year, with effect since 2000/2001." (Paras. 7.190-191)

Second, the Panel recalled its view that because the footnote does not contain any reference to budgetary outlays, it cannot be considered as a component of a scheduled export subsidy commitment. On this point, the European Communities argued that footnote 1 contains a "*de facto* budgetary limit of 1.6 million multiplied by the average export refund which can be granted within the first component of the EC's commitments" because the refunds for both types of sugar must be the same. However, the Panel rejected this argument, noting, *inter alia*, that under the terms of the footnote, the budgetary outlay commitment level "cannot be predicted beforehand." (Paras. 7.192-194) Thus, the Panel concluded that the footnote conflicts with the requirements of Article 3.3 that commitments be expressed in terms of both quantity and budgetary outlays, and it reiterated its statement that the footnote is of no legal effect and does not enlarge or otherwise modify the European Communities' quantity commitment level. (Para. 7.196)

Finally, the Panel considered whether, as argued by the European Communities, footnote 1 is a "negotiated departure" from the Modalities Paper. (Para. 7.199) Reviewing the relevant negotiating history presented by the parties, the Panel concluded that the complainants did not agree to allow the European Communities to deviate from the Agriculture Agreement and the Modalities Paper. Furthermore, the Panel said, "even assuming that the participants in the Uruguay Round were authorized to negotiate departures from the Modalities Paper which is not clear, such negotiated departure would only be relevant to the extent that it is reflected in the European Communities' Schedule and is WTO consistent." (Paras. 7.203-220)

On the basis of all of the above, the Panel stated, "even if it were to be considered to include a commitment limiting subsidization for 1.6 million tonnes of ACP/India equivalent sugar, which it does not, Footnote 1 to Section II, Part IV of the EC's Schedule is inconsistent and conflicts with Articles 3, 8 and 9 of the Agreement on Agriculture and as such cannot be read harmoniously with the provisions of the Agreement on Agriculture." Furthermore, the "content of Footnote 1 cannot constitute a second component of the European Communities' overall commitment level for export subsidies on sugar," and the footnote "cannot constitute an agreed departure from the European Communities' basic obligations under the Agreement on Agriculture." Therefore, the Panel found that "the content of Footnote 1 is of no legal effect and does not enlarge or otherwise modify the European Communities' quantity commitment level specified in Section II, Part IV of its Schedule to be 1,273,500 tonnes of sugar per year, or its budgetary outlay commitment of €499.1 million per year, with effect since 2000/2001."
(Paras. 7.220-221) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

**Agriculture Agreement Article 9.1(a) - Exports of "ACP/India Equivalent Sugar"

The complainants claimed that "in each of the last five years, the European Communities' total export of sugar exceeds its commitment levels," and, in particular, for "the marketing year 2001-2002, the European Communities had exported 1,725,100 tonnes of ACP/India equivalent sugar alone: such subsidized exports were in excess of the European Communities' scheduled commitment level of 1,273,500 tonnes." According to the complainants, "[t]he export refunds granted to ACP/India equivalent sugar were the same per unit as the export refunds granted to A and B quota sugar and thus these payments clearly constituted 'direct subsidies' provided by government, to firms, to the exporting industry and to producers of sugar, (an agricultural product), and were 'contingent on export performance,'" within the meaning of Agriculture Agreement Article 9.1(a). (Paras. 7.232-233)

The European Communities did not contest these arguments and did not "deny the Complainants' allegation that ACP/India equivalent sugar benefits from the same level per unit of export refunds as A and B sugar do." Rather, as explained in the section related to commitment levels, it argued that these exports are not included in its commitment levels. As a result, the Panel concluded that the European Communities "has not demonstrated that its exports of ACP/India equivalent sugar are not subsidized, as the evidence indicates that exports of what the European Communities considers to be ACP/India equivalent sugar receive export subsidies within the meaning of Article 9.1(a) of the Agreement on Agriculture." Thus, it concluded, the European Communities has been acting inconsistently with Agriculture Agreement Articles 3 and 8. (Paras. 7.235-238)

**Agriculture Agreement Article 9.1(c) - Exports of C Sugar

Recalling its earlier conclusion that the quantity of EC sugar exports exceeded commitment levels, the Panel examined whether the European Communities had proven that its exports of C sugar are not subsidized. In this regard, the complainants argued that, under the standard set forth by the Appellate Body in Canada - Dairy, Article 21.5, there is a "payment," in the sense of Article 9.1(c), because of below cost sales of C beet to C sugar producers and also because of below cost sales of C sugar for export. (Paras. 7.239-243)

In addressing this issue, the Panel first recalled certain relevant aspects of the measure at issue, Council Regulation (EC) No. 1260/2001. It noted that one key feature of the measure is the establishment of price support, with an intervention price that is "approximately three times" the world market price. The measure provides rules for three categories of sugar: A and B quota sugar, and C sugar "which is basically excess sugar." The price support applies only to A and B sugar. A, B and C sugar are produced, respectively, from A, B and C beet, with C beet "being used exclusively to produce C sugar." Sugar producers are required to pay beet growers a designated minimum price for A and B beet; the price paid for C beet is "generally lower than that paid for A and B beet," but there "is no regulated minimum price for C beet." (Paras. 7.244-247)

The Panel noted that "because growers of C beet are also growers of A and B beet and because C beet can only be used in C sugar, which in turn belongs to the same production line as A and B quota sugar, the EC sugar regime ensures that the sale of under-priced C beet to C sugar producers is an integral part of the governmental regulation of the sugar market." To be competitive, the Panel explained, "C sugar must be exported at world price." However, because "of the low world price relative to C sugar cost of production, C sugar producers exercise pressure on C beet growers so that C beet is sold to C sugar producers at reduced prices." Furthermore, it said, "various aspects of the sugar regime provide
the beet growers with an incentive to produce beet beyond their A and B quota levels, as C beet."
As a result, the "discounted prices for C beet below its cost of production and the incentive for beet growers to produce C beet serve as an advantage for the export production of C sugar." (Para. 7.247)

In addition, the Panel observed that the "export refunds" under the sugar regime are "high," covering the difference between the EC intervention price and the world price. These refunds, the Panel said, add to the revenues received by EC sugar producers, and "may constitute one of the source [sic] of the spill-over effects of the EC sugar regime into the export production of C sugar." (Paras. 7.249-250)

With this as background, the Panel examined whether the exports of C sugar are subsidized, under Article 9.1(c). In this regard, the Panel noted that Article 9.1(c) "requires the demonstration of three elements": (1) that "payments" be made; (2) that those payments be made "on the export of an agricultural product"; and (3) that those payments be "financed by virtue of governmental action." The complainants had pointed to a "series" of such "payments," and the Panel examined the following two: "(a) payment in the form of below costs C beet sales to C sugar producers/exporters"; and "(b) payment in the form of cross-subsidization resulting from the profits made on sales of A and B sugar used to cover the fixed costs of the production/export of C sugar." The Panel considered each in turn. (Paras. 7.251-253)

"Below cost" sale of C beet to C sugar producers

In addressing the alleged below cost sale of C beet to C sugar producers, the Panel considered each element of Article 9.1(c) separately.

First, with regard to the existence of a "payment," the complainants argued that "C beet, as the main input for the production of C sugar, is sold to C sugar producers/exporters at prices well below the total average cost of production of such C beet and, therefore, through this transaction provides C sugar producers with a payment-in-kind within the meaning of Article 9.1(c)." (Para. 7.254)

Applying this standard here, the Panel recalled the findings of the Appellate Body in Canada - Dairy, Article 21.5. There, the Appellate Body concluded that "the word 'payments' [in Article 9.1(c)] embraces 'payments-in-kind' and 'specifically contemplates that the export subsidy may be granted in a form other than a money payment,' including revenue foregone." The Appellate Body had continued, "[r]evenue or value may be foregone in instances when the price charged by the producer of the product is less than the product's proper value to the producer." To determine the "proper value to the producer in assessing whether a transfer of economic resource has taken place," it had said, "a 'payment' analysis 'requires a comparison between the price actually charged by the provider of the goods or services ... and some objective standard or benchmark which reflects the proper value of the goods or services to their provider ...'" The benchmark it chose was "the cost of production" of the milk at issue. In this regard, the Appellate Body had determined that "if the producers of milk sell their milk below their total average cost of production, this loss must be financed from some other sources including by virtue of governmental action." Thus, it said, "[i]t the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, possibly 'by virtue of governmental action.'" (Paras. 7.258-259)

Applying this standard here, the Panel said that, similar to the Dairy case, it would examine "whether the producers, here C beet growers, forego a portion of their proper value by way of the below total costs price charged to the producers of C sugar, or in other words whether C beet growers transfer economic resources, discounted C beet, in favour of C sugar producers/exporters." (Para. 7.261) In this regard, it said that "the total cost of production of C beet is an appropriate benchmark for determining whether the sales of C beet to C sugar producers provide a 'payment' to the producers of C sugar within
the meaning of Article 9.1(c) of the Agreement on Agriculture."  (Para. 7.264) According to the Panel, there is "uncontested evidence that C beet is sold to C sugar producers at prices well below its cost of production, showing that the price received for C beet – calculated at 58 to 60 per cent of the price for C sugar – was below the total cost of production of that beet throughout the years 1992/93 to 2002/03." In fact, the Panel noted, the European Communities "does not contest the cost of production figures and related data offered by the Complainants." (Paras. 7.265-267)

On this basis, the Panel stated, "[w]hen C beet is sold to C sugar producers at rates that are below its total cost of production, there is, in effect, a payment, i.e. a payment-in-kind, being made to the C sugar producers to the extent that the proper value of C beet is not reflected in its price and, hence, involves a 'payment' within the meaning of Article 9.1(c) of the Agreement on Agriculture by way of value foregone." Therefore, the Panel found that "the below total cost of production sales of C beet to C sugar producers involves a payment within the meaning of Article 9.1(c) of the Agreement on Agriculture." (Paras. 7.269-270)

Second, the Panel considered whether the "payment-in-kind" through sales of below cost C beet was made "on the export." In this regard, the complainants argued that "since C beet can only be used in the processing of C sugar, which in turn must be exported, any payments received by C sugar producers are 'on the export.'" In response, the European Communities argued that, "even if the relevant EC measures provide an indirect benefit to C sugar, the governmental action which provides these benefits is not contingent upon the export of C sugar, since sugar producers may qualify for A and B quota rights and privileges regardless of whether they produce C sugar for export." (Paras. 7.271-272)

In addressing this issue, the Panel first stated its view that a payment "on export" does not need to be "contingent upon export." In this regard, it explained, "[a]n analysis of Article 9.1(c) would put its emphasis on whether the payment in question received is on the export, not on whether, as appears to be the case, the EC price support as a whole is de facto contingent upon C sugar being exported." That is, "when identifying whether a payment is on the export as defined under Article 9.1(c) of the Agreement on Agriculture, once a payment is identified, the focus is on whether this payment is made on the export, and not on whether the source of the payment is dependent or contingent on export production." Based on an interpretation of the word "on," the Panel concluded that "on export" need not be "contingent" on export "but rather should be 'in connection' with exports." (Paras. 7.273-275)

Applying this interpretation to the facts here, the Panel considered there to be a "very close link" between C beet production and C sugar production. Because C beet "may be processed only into C sugar which in turn (unless carried forward as quota sugar as mentioned above) must be exported, payments by way of below cost of production sales of C beet to C sugar producers are 'on the export.'" In other words, the Panel said, "the payment by way of discounted C beet is only afforded to C sugar producers, and ultimately 'on the export.'" (Paras. 7.276-277)

On this basis, the Panel found that "the payments to C sugar producers by way of discounted below total cost of production sales of C beet by C beet growers are on the export within the meaning of Article 9.1(c) of the Agreement on Agriculture." (Para. 7.279)

Finally, the Panel considered whether the "payments-in-kind" at issue are "financed by virtue of governmental action." In this regard, the complainants argued that "the European Communities' governmental actions are indispensable to the transfer of resources described above," and "finance growers to supply C beet to C sugar producers at prices that do not reflect the average total cost of production of the beet, and for those processors, in turn, to provide C sugar to buyers at world market prices that did not reflect its average total production cost." (Para. 7.280)
In addressing this issue, the Panel began by referring to the Appellate Body's findings in Canada - Dairy, Article 21.5. The Panel recalled that a "demonstrable link" and "clear nexus" between the "financing of the payments" and the "governmental action" must be established in order for the payment to qualify as a payment "by virtue of governmental action." (Para. 7.281) Examining the measure at issue, the Panel considered that "the Complainants have submitted prima facie evidence that C sugar producers provide positive incentives for growers to plan production above (the processor's) quota, by including an amount of C beet in a grower's beet delivery quota, at an average price, or paying a higher price of the first slice of over quota beet." Furthermore, the European Communities "controls both the supply and the price of sugar in the internal market," and this "controlling governmental action is 'indispensable' to the transfer of resources from consumers and tax payers to sugar producers for A and B quota sugar and, through them, to growers for A and B quota beet." (Paras. 7.283-291)

Therefore, the Panel found that "C sugar producers receive payments on export financed by virtue of governmental action through various governmental actions as specified above, within the meaning of Article 9.1(c) of the Agreement on Agriculture." (Para. 7.292) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

Because each of the three Article 9.1(c) elements was met, the Panel found 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." Thus, pursuant to Article 10.3, the Panel found that "the European Communities has not demonstrated that exports of C sugar that exceed the European Communities' commitment levels since 1995 and in particular since the marketing year 2000/2001, have not been subsidized." Consequently, it concluded, "the European Communities is acting inconsistently with Articles 3 and 8 of the Agreement on Agriculture." (Para. 7.293) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

"Cross-Subsidization Resulting from the EC Sugar Regime"

The Panel then considered whether "the cross-subsidization resulting from the EC sugar regime constitute[s] a payment on exports by virtue of governmental action." In this regard, the Panel examined each of the three elements of Article 9.1(c), as set forth above. At the outset, the Panel noted "that the producers of A, B and C sugar are the same companies and that the production of all three classifications of sugar is made in a continuous line of production." Furthermore, it said, "any alleged payments in the production of sugar, wherever they take place, derive from the high prices paid for A and B quota sugar on the EC domestic market." As a result, the Panel "concentrate[d] its analysis of C sugar on the issue of cross-subsidization." (Para. 7.294)

With regard to whether a "payment" exists, the complainants argued that "the advantages that exporters of C sugar receive through the transfer of economic resources that result from the EC sugar regime … are payments," in that the sugar regime's "combination of guaranteed intervention prices, production quotas, export refunds and import restraints all limit the quantity of quota sugar that may be sold in the internal market and directly results in the high domestic prices for A and B quota sugar." In addition, they argued that "the EC sugar regime and the high administered above-intervention price paid for domestic EC sugar result in an eventual payment to EC sugar exporters within the meaning of Article 9.1(c)." Specifically, they contended "that the high prices result in covering the fixed costs to produce the exported C sugar, hence, serving as a subsidy to C sugar producers." (Para. 7.295)

In addressing this issue, the Panel first recalled certain statements by the Appellate Body in Canada - Dairy, Article 21.5, in particular its reference to profits from subsidized domestic sales "spilling over" to allow export sales at below cost prices. (Paras. 7.297-300)
Next, the Panel noted that on the facts of this case, "the data illustrates that the price charged for C sugar does not even remotely cover its cost of production." As a result, it said, "profits are only possible if C sugar is being sold above average variable costs despite being sold below its average total cost of production and its fixed costs are financed through some other way." (Paras. 7.301-302)

Reviewing the operation of the sugar regime, the Panel concluded that "there is clear evidence that the relatively high EC administered domestic market (above-intervention) prices for A and B quota sugar allow the sugar producers to recover fixed costs and to sell exported C sugar over average variable costs but below the average total cost of production." In this regard, the Panel observed that "A, B or C sugar are part of the same line of production and thus to the extent that the fixed costs of A, B and C 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." Therefore, the Panel found, "this cross-subsidization constitutes a payment in the form of a transfer of financial resources." (Paras. 7.303-310)

On this basis, the Panel found that "the cross-subsidization taking place through the cumulative effect of various measures involved in the operation of the EC sugar regime, including high prices charged to domestic consumers, enables C sugar producers to produce and sell C sugar." As a result, "there is 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. 7.314) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

Next, the Panel considered whether this payment was "on the export." On this issue, the Panel first recalled its earlier conclusion that "an analysis of Article 9.1(c) shows that the focus of the analysis is on whether the payment received is 'on the export' or provides an advantage to the exports, not whether the whole EC regime, or the cross-benefits resulting from A and B quotas are contingent upon C sugar being exported." Here, it noted, C sugar, "unless carried forward, must be exported …." Because of this "legal requirement," it said, "advantages, payments or subsidies to C sugar, that must be exported, are subsidies 'on the export' of that product." (Paras. 7.317-321) Therefore, the Panel found "that the payment on C sugar production in the form of transfer of financial resources through cross-subsidization resulting from the operation of the EC sugar regime is on export within the meaning of Article 9.1(c) of the Agreement on Agriculture." (Para. 7.322) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

Finally, the Panel considered whether the payment is "financed by virtue of governmental action." On this issue, the complainants argued that "the controlling governmental actions" here are "indispensable" to the transfer of resources from consumers and taxpayers to sugar processors and beet growers. (Para. 7.323)

At the outset, the Panel recalled that the "demonstrable link" and clear "nexus" between the "financing of payments" and the "governmental action" must be established in order to qualify as a payment "by virtue of governmental action." Here, it said, of particular relevance is the Appellate Body's discussion, in paragraph 132 of Canada - Dairy, Article 21.5, of the word "financed" as referring to the "mechanism or process" put in place by the government: "The word refers generally to the mechanism or process by which financial resources are provided to enable 'payments' to be made." (Paras. 7.324-325)

Reviewing the EC sugar regime, the Panel said that this regime "creates incentives to breach the ordinary limits of domestic support by encouraging producers to produce more sugar for export in order to ensure they fulfil their quotas and prevent them from losing access to the preferential quotas." In addition, "by virtue of the high prices charged to domestic consumers and the operation of the A and B
quotas as well as other features of the EC sugar regime, exporters of C sugar can cover a significant portion of their production costs and make profitable export sales." Therefore, the Panel concluded that "EC sugar producers finance sales of C sugar at below cost of production directly by participating in the domestic market and making sales internally at high prices as regulated by the European Communities," as "[t]he European Communities' governmental action controls virtually all aspects of domestic sugar supply and pricing." (Paras. 7.326-331)

**On this basis, the Panel found that "the EC sugar regime and the cross-over benefits that it creates are thus the direct and foreseeable consequences of actions by the European Communities, within the meaning of Article 9.1(c) of the Agreement on Agriculture."** (Para. 7.333)

As all three elements of Article 9.1(c) were met, the Panel found that, pursuant to Article 10.3, the European Communities "has not demonstrated that exports of C sugar that exceed the European Communities' commitment levels since 1995 and in particular since the marketing year 2000/2001, are not subsidized." **Consequently, it found, the European Communities is acting inconsistently with Agriculture Agreement Articles 3 and 8.** (Paras. 7.334-335) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

"**Interpretation and Correction**" of the EC Schedule in Light of the Modalities Paper

The European Communities argued that the figures set out in its Schedule were based on the European Communities' understanding that exports of C sugar did not benefit from export subsidies. In this regard, the figures that appeared under the heading "annual and final quantity commitment levels" were calculated from the "base quantity level" by applying the reduction percentage agreed in the Modalities Paper, which the European Communities considered an "agreement" reached in connection with the conclusion of the Agriculture Agreement and which therefore constitutes relevant "context." Using the Modalities Paper to set its commitment levels, the European Communities had not taken into account exports of C sugar. At the time these levels were set, and even after the completion of the Uruguay Round, it was understood that exports of C sugar were not subsidized. However, this understanding changed as a result of the **Canada - Dairy, Article 21.5** case. The European Communities submitted that "the interpretation made by the Appellate Body in Canada – Dairy, on which the Complainants had principally based their allegations, was a novel one, which could not have been anticipated by any participant when the commitments were scheduled." With C sugar considered to have been subsidized, based on the **Dairy** interpretation, and therefore taken into account in the Schedule, the European Communities concluded that "the base quantity level would have been 3,188,200 tonnes instead of 1,612,000 tonnes, and the final commitment level would have been 2,514,700 tonnes (i.e. 79 per cent of 3,188,200 tonnes) instead of 1,273,500 tonnes (i.e. 79 per cent of 1,612,000 tonnes) …." Thus, the European Communities argued that the breach of the reduction commitments alleged by the complainants "would thus result exclusively from a scheduling error." (Paras. 4.122-127, 7.341-344) Thus, the European Communities submitted:

[S]hould the Panel find that the C sugar regime provides export subsidies in excess of the reduction commitments, the only course of action consistent with the requirements of good faith would be for the Complainants to agree to the correction of the European Communities' scheduling commitments so as to include the exports of C sugar in the base levels and to rectify the annual commitments accordingly.

In addressing this issue, the Panel first noted that the Modalities Paper is not a "covered agreement," but said that it could be "relevant" when interpreting the Agriculture Agreement, including Members' Schedules. (Para. 7.350) Then, the Panel rejected the modification to the Schedule requested
by the European Communities. In this regard, the Panel said, "[e]ven if there were clear evidence that if the European Communities had known that C sugar was subsidized, it would have increased its base quantity to include additional subsidies to C sugar, the fact that the European Communities did not do so at the time, does not in and of itself entitle the European Communities to claim a correction of its Schedule today." It further stated that the EC assertion that "the only course of action is for the Complainants to agree to the correction or revision of the EC Schedule is not a matter for which the Panel has any authority as it goes beyond the scope of a panel recommendation which, according to Article 19.1 of the DSU, should be limited to recommending that the concerned Member 'bring the measure into conformity with the Agreement on Agriculture,' and the Panel "is not authorized, under the DSU, to force the Complainants to agree to such a correction or revision of the European Communities' Schedule." (Paras. 7.352-354)

**DSU Article 3.8 - Presumption of Nullification or Impairment**

The European Communities argued that even if the export of C sugar and equivalent ACP/India sugar resulted in a violation of Agriculture Agreement Articles 3.3, 8 or 10.1, such violation "would not nullify or impair any benefits accruing to the complaining parties." In this regard, it contended, DSU Article 3.8 "made clear that, while a finding of violation of a covered agreement gave rise to a presumption of nullification or impairment of benefits accruing under that agreement, the defending party had an opportunity to rebut such presumption." It argued, "the ordinary meaning of the term 'adverse impact' in Article 3.8 of the DSU did not require that the defending party had to show that the alleged violation had had no actual effect on the Complainants' exports to establish the absence of such impact." Here, it asserted, the European Communities had shown "that the Complainants had suffered no 'adverse impact' because they could not have expected that the European Communities would stop exporting C sugar." (Paras. 7.359-360)

DSU Article 3.8 provides:

> In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules has an adverse impact on other Members parties to that covered agreement, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge.

The Panel considered that the European Communities' "reliance on the Complainants' general expectations or lack thereof, is not sufficient to rebut the presumption of nullification of benefits pursuant to Article 3.8 of the DSU, once a violation has been demonstrated." The complainants, it said, "had legitimate expectations that the competitive relationship of their sugar would not be nullified or impaired by the export subsidies of the European Communities provided in excess of the European Communities' commitment level," and "also had legitimate expectations that the European Communities would comply with the Agreement on Agriculture, including the European Communities' obligation not to provide export subsidies above its commitment level." (Para. 7.370) Furthermore, the Panel noted that the European Communities "has not rebutted the evidence submitted by the Complainants with regard to the amount of trade lost by the Complainants as a result of the EC sugar regime." (Para. 7.372)

Therefore, the Panel concluded, "the European Communities has not effectively refuted the Complainants' allegation that the European Communities' violations nullified or impaired the benefits to which they are entitled." In particular, it said, "the European Communities has not submitted sufficient factual evidence to suggest that the Complainants did not suffer an 'adverse impact' from the European Communities' exports of C sugar and ACP/India equivalent sugar provided in excess of the European
Communities' commitment level." As a result, the Panel found that "the European Communities' violations of the Agreement on Agriculture nullified or impaired the benefits to which the Complainants were entitled under the Agreement on Agriculture." (Paras. 7.373-374) (On appeal, the Appellate Body upheld the Panel's findings. See DSC for EC - Sugar Subsidies (AB).)

**SCM Agreement Article 3.1(a) (Judicial Economy)**

The complainants argued that the EC sugar regime violates SCM Agreement Article 3.1(a). Even though claims against the regime had been made under the Agriculture Agreement, the complainants argued that findings under the SCM Agreement were important because of the remedy available under SCM Agreement Article 4.7, which has, *inter alia*, a shorter implementation time-frame than that for Agriculture Agreement violations. (Paras. 7.375-379) Recalling that it had already found the EC sugar regime to be inconsistent with Agriculture Agreement Article 3.3 and Article 8 (through Article 9.1(a) and Article 9.1(c)), the Panel considered whether it should apply judicial economy to the SCM Agreement claims. (Para. 7.381)

In this regard, it rejected the complainants' arguments based on the different time-frames for implementation under Article 4.7, concluding that these differences do not require that a finding be made under Article 3.1(a). In addition, the Panel noted that "the Complainants' have not set forth their claims under Article 3 of the SCM Agreement in quite as clear and unambiguous a manner as under the Agreement on Agriculture," but rather have "focused on their claims" under the Agriculture Agreement. Thus, the Panel considered that "the important questions presented under the SCM Agreement in this dispute would be best decided in a case where they have been further argued by the parties." (Paras. 7.384-386)

On this basis, the Panel exercised judicial economy and declined to examine the complainants' export subsidy claims under SCM Agreement Article 3. (Para. 7.387) (On appeal, the Appellate Body reversed the Panel's findings, but was unable to complete the analysis. See DSC for EC - Sugar Subsidies (AB).)

**DSU Article 19.1 - Suggestion for Implementation**

Pursuant to DSU Article 19.1, the Panel suggested that "in bringing its exports of sugar into conformity with its obligations under Articles 3.3 and 8 of the Agreement on Agriculture, the European Communities consider measures to bring its production of sugar more into line with domestic consumption whilst fully respecting its international commitments with respect to imports, including its commitments to developing countries." (Para. 8.7)

**COMMENTARY**

*Agriculture Agreement Article 9.1(c) - "On the Export"*

In interpreting the phrase "on the export" in Article 9.1(c) in the context of the claims relating to below cost sales of C beet, the Panel took the view that the standard for "on the export" is not the same as the standard for "contingent upon export," which is the phrase used in several other SCM and Agriculture Agreement provisions. According to the Panel, the use of the word "on" here indicates that the standard for "on the export" is "in connection" with exports. Thus, it said, the payment need not be "contingent" on export, but merely "in connection" with exports. (See paras. 7.271-275) Although the Panel did not explain its view of the precise distinction between the two standards, implicit in the Panel's statements appears to be the idea that "contingent upon export" is a narrower standard, covering fewer measures.
While the Panel's decision to interpret "on the export" as "in connection" with exports appears reasonable, we note that prior jurisprudence in this area has sometimes taken a different approach (at least in a formal sense, although the practical effects may be the same). In this regard, the Canada - Dairy panel said that "on the export" does, in fact, mean export contingent, stating: "the term 'payment on the export of an agricultural product' means, indeed, that the payment is conditional or contingent on the export of such product." (See para. 7.90 of Dairy)

In any event, in this case the interpretation of "on the export" is not likely to affect the outcome, as the measure at issue here clearly would meet either standard. As the Panel found, "C beet may be processed only into C sugar which in turn (unless carried forward as quota sugar as mentioned above) must be exported." (See para. 7.277)

On appeal, the Appellate Body addressed this issue only in the context of the claims related to "cross-subsidization," and said that the Panel had not, in that context, made a finding that "on the export" means "in connection with." See DSC for EC - Sugar Subsidies (AB).

Interpretation of EC Schedule / Principle of Effective Treaty Interpretation

A key issue in this dispute was the determination of the European Communities' commitment level for export subsidies on sugar. The EC Schedule provides both a quantity reduction commitment (1,273,500 tons) and a budgetary outlay reduction commitment (€499.1 million) for sugar. In addition, though, footnote 1 to the sugar entry in the EC Schedule sets forth a somewhat cryptic comment related to these commitment levels. Specifically, the footnote 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, its commitment, based on its sugar entry and footnote 1, is the following: there is a general commitment not to export more than 1,273,500 tons of subsidized sugar. However, this commitment level does not include the 1,600,000 tons of sugar imported from the ACP/India. Referring to this amount, the European Communities argued that it may export 1,600,000 tons of subsidized sugar, that is, an amount "equivalent" to the amount of its ACP/India imports, and this amount is outside of its general commitment.

The European Communities put forward a number of arguments in support of its position. In order to clarify the issues involved, we discuss several of these here, along with the Panel's views of the issues.

First, there was the issue of whether the footnote conflicts with the Agriculture Agreement, and, if so, what are the ramifications of such a conflict. In particular, one key question was whether the Agriculture Agreement requires that the entries for export subsidy commitments in Members' Schedules provide both a quantity reduction commitment and a budgetary outlay reduction commitment. The Panel decided that both commitments are required, and that the absence of one of these amounts therefore leads to a conflict with the Agreement.

Applied to the footnote here, the Panel said that the absence of a budgetary outlay amount in the footnote makes the footnote "legally invalid." While the Panel considered that, in the interpretation of footnote 1, "it must use its best endeavours to give due meaning to the said Footnote and respect the principle of effective treaty interpretation," here its "best endeavours" to do so were unsuccessful. Thus, the Panel ended its analysis of the issue, and concluded that the EC commitment level is 1,273,500 tons.
We note that, in addition to the reasoning used in the Panel's finding, another criticism of the footnote is that, by its terms, it states that for the exports in question the European Communities "is not making any reduction commitments." However, it is not clear that a Member can schedule the absence of a commitment. Arguably, there are only two categories that export subsidies for agricultural products can fall into: (1) subsidies that are prohibited (i.e., those subsidies that are unscheduled), or (2) subsidies that are subject to reduction commitments in the Schedule. There is no third category of products for which export subsidies may be provided yet the subsidies are not subject to reduction commitments. Thus, it is possible that the footnote could be declared "legally invalid" on this basis as well.

While the Panel's approach in declaring the footnote "invalid" is a reasonable one, we note two possible alternative approaches. First, it may be more appropriate to examine the text of the footnote in combination with the figures set out in the Schedule, rather than in isolation as the Panel appeared to do. Thus, under this approach, the quantity amount in the Schedule would be based on the addition of the two quantity figures provided (1,273,500 and 1,600,000 tons), while the budgetary outlay amount would be the €499.1 million figure provided. Second, it could also be argued that the absence of a specific amount for budgetary outlay reductions in the footnote means that an unlimited amount of subsidies can be given on those quantities. Thus, for the 1,600,000 tons mentioned in the footnote, an unlimited amount of subsidies may be given.

If either of these two alternative approaches were taken, the footnote could be considered valid, and the question would then arise as to what the terms of the footnote actually mean. According to the European Communities, the footnote allows it to export an amount of subsidized sugar that is "equivalent" to the amount referenced there (1,600,000 tons), thus allowing a total amount of subsidized sugar exports of 2,873,500 tons. This amount, the European Communities argued, may consist of any sugar products from EC sugar producers, regardless of the products' origin. By contrast, a different interpretation of the footnote is that only the actual ACP/India sugar imports themselves may be offered as subsidized exports. Arguably, this interpretation is more consistent with the footnote's terms, which refer to "exports of sugar of ACP and Indian origin," and which do not make any mention of an "equivalence" standard. The Panel itself agreed with this view. (See para. 7.183)

On appeal, the Appellate Body upheld the Panel's ultimate findings, although it did not agree that the footnote was "of no legal effect." However, 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." See DSC for EC - Sugar Subsidies (AB).