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ERIADOR- CERTAIN MEASURES AFFECTING THE ELECTRICITY SECTOR A WTO CASE STUDY

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ERIADOR- CERTAIN MEASURES AFFECTING THE ELECTRICITY SECTOR
A WTO CASE STUDY

TRABAJO DE GRADO PRESENTADO POR DANIEL FELIPE BARRERA GRANADOS, NICOLÁS CABALLERO HERNÁNDEZ Y SANTIAGO OSORIO SALAZAR, BAJO LA DIRECCIÓN DEL DOCTOR ALFONSO MIRANDA LONDOÑO COMO REQUISITO PARA OPTAR AL TÍTULO DE ABOGADO

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List of Abbreviations

AB	Appellate Body
ABR	Appellate Body Report
Art.	Article
Arts.	Articles
BEC	Borduria Energy Corporation
CFE	Cold Fusion Energy
CT	Clean Tech
COP21	2015 Paris Climate Conference
DSB	WTO Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
EB	Electricity Borduria
EC	European Commission
EL	Eribank Loan
EEC	Eriadorian Electricity Corporation
EEM	Eriadorian Electricity Market
EG	Electricity Generator
EGs	Electricity Generators
REGE	Renewable Energy Generation Equipment
FCPRE	Framework Convention on the Promotion of Renewable Energy 2010
FE	Future Energy

FS, FFSS	Fusilliscope, Fusilliscopes
FSPF	Fusilliscope Production Facility
FITS	Feed-in-Tariff Scheme
GATT	General Agreement on Tariffs and Trade
GOE	Government of Eriador
ICJS	International Court of Justice Statute
IEA	International Energy Agency
IFFP	Innovation for the Future Program
IFFG	Innovation for the Future Grant
LTPA	Long Term Purchase Agreement
LTC	Long-Term Contracts
MTC	Medium-Term Contracts
NRE	Non-Renewable Energy
p./pp.	Page/Pages
para./paras.	Paragraph/Paragraphs
PR	Panel Report
RE	Renewable Energy
SCM	Agreement on Subsidies and Countervailing Measures
SMT	Spot-market Transactions
SOCB	State Owned Commercial Banks
ST	SolarTech
UNRTW	UN Resolution Transforming Our World

USA	United States of America
VCLT	Vienna Convention on the Law of Treaties
WEP	Wholesale Electricity Price
WTO	World Trade Organization

ABSTRACT

On the verge of climate change catastrophe, the disciplines of subsidies and international trade seem to be unrelated. However, the issue generates much debate and even some international disputes before the World Trade Organisation. Indeed, the world claims for development of energetic alternatives and renewable energies to fuel our modern world. The problem is: how to develop these capital intensive huge projects? This text provides a purported answer that has been highly controversial in the international trade scenario, which can be summarized in a short assertion: renewable technologies must be developed by means of governmental subsidies. The text first provides an insight to the subsidies discipline and its economic and normative arguments as policy instruments. This section is closed by a thorough analysis of the dispute Canada- Renewable Energy where the economic discussion gets juridical. On the second part, the discussion gets practical. The reader will find the case of Eriador-certain Measures Affecting the Electricity Sector, which was the official case of the 14th edition of the ELSA Moot Court Competition on WTO Law (edition 2015-2016). In this case, the two fictitious countries face a hypothetical scenario where renewable energies and trade collide; the controversy is raised in the forum of a WTO hypothetical panel. The reader will find the case, the submission of the respondent party and the submission of the Complainant party (in Annex A). The text pretends not to defend a particular pro or negative opinion about subsidies as a means of developing key projects but to deepen the discussion amongst trade scholars and critical citizens.

Key word: subsidies, World trade Organization, dispute settlement, renewable enmergies.

I. SECTION I- INTRODUCTION

1. GENERAL INTRODUCTION –PLAN

The ELSA Moot Court Competition on WTO Law is a simulated case of the WTO Dispute Settlement System in which more than 90 universities from more than 35 countries worldwide participate[1]. In the first stage of the competition, the teams –chosen by each participating Law Faculty- send in written submissions for the complainant and the respondent sides, in a fictitious

[1] That is the case of the 14th Edition of the ELSA Moot Court Competition on WTO Law, according to the oficial website. See the Final Report in: http://emc2.elsa.org/former-editions/ (last visited: October 24 2016)

case drafted by a reputed law professor of Trade Law. In the second stage -that was held this edition in Queen's University, Canada for the All-American Regional Round-, the teams have the chance to present their oral submissions in front of panels, which consist of WTO and trade law experts. Finally, the 20 qualifying teams from the five regional rounds (two European rounds, an Asia-Pacific round, an All-American round and an African round) compete against each other in the Final Oral Round that is held in Geneva, Switzerland, at the WTO headquarters.

Our team had the opportunity to compete in the 14th edition of the competition, and the corresponding case -drafted by Professor Andrew Lang of the London School of Economics- dealt with subsidies for the production of renewable energy equipment and for the purchase of renewable energy. On 18 September 2015, the Case was published and the edition was officially launched, counting a number of 90 registered teams by that date. Then, the All-American regional round was held on March, and the Final Oral Round at the beginning of June. The team of the Pontificia Universidad Javeriana was awarded with the prize for winning team in the Regional Round and in the Final Oral Round. Additionally, at the Regional Round, the team was awarded with the prize for best orators of the Preliminary rounds, the Semi-Final and the Grand Final, as well as the prize for the Best Written Submission of the Respondent –which makes integral part of this dissertation- and for the Best Overall Written Submissions.

The purpose of this paper is to present the Written Submission of the Respondent which not only won the prize for the Best Written Submission at the Regional Round, but was also recognized as the second Best Written Submission in the Final Oral Round[2], and to provide context for its understanding, including a general introduction to subsidies from their economic and legal

[2] See the Final Report in: http://emc2.elsa.org/former-editions/ (last visited: October 24 2016)

perspective, as well as an analysis of the landmark case of the WTO –*Canada-Renewable Energy-* in which the fictitious case was based on general terms.

2. SUBSIDIES –AN ECONOMIC PERSPECTIVE

Subsidies are an important instrument of policy-making in contemporary modern States. This has been the case, presumably, since Nation-States exist or even earlier[3]. Indeed, States make economic decisions based on several factors, namely: Job creation, eradication of poverty, industry development, and fiscal balance, amongst many others[4]. The achievement of these goals depends on many factors and when they are unbalanced or do not develop in the way that a government estimates convenient, subsidies are one of the most policy-efficient[5] instruments available to correct market failures or shape the behaviour of a sector of an economy. Regardless of the *normative* arguments for utilising subsidies (what *ought* to be), economics have provided sufficient arguments to discuss the effects of subsidies; lets take a look to these positive arguments.

2.1 Subsidies from an economic standpoint –Notion and Economic Rationale

Defining a subsidy can be a complex task if we bear in mind that many situations can be comprehended by the definition of a subsidy. In essence, we agree with the AB when it stated that a subsidy "*captures situations in which something of economic value is transferred by a government to the advantage of a recipient*"[6]. In a negative way, a subsidy "*is considered an*

---

[3] Indeed, Henri Pirenne, a recognised Belgian historian and predecessor of the Annals historical school of the first half of the XX century, suggests that cities in the XIV and XV century had embraced a protectionist mercantilist approach and applied towards different industries (wool and textiles, wine and perfumes, for instance) incentives to bust their production. In fact, Italian cities as well as other commercially developed regions (Flanders and Hanseatic cities) were keen to enhance a domestic industry by granting reliefs, privileges and even direct transfer of funds. See: Pirenne, Henri (1983), chapter VI.

[4] Schwab, Klaus (2015-2016), pp. 10-21.

[5] Bhagwati, Jagdish & Ramaswami, V. K. (1963), p. 50.

[6] ABR, *US – Softwood Lumber IV*, para. 51.

antonym to a tax, and thus connotes a transfer of money from the government to a private actor."[7] Subsidies are with taxes, in essence, fiscal instruments[8].

Now, why do governments use subsidies? "*In a world of complete and perfectly competitive markets, mere interaction between supply and demand results in an efficient allocation of resources and a level of output produced at the lowest possible price, which equals the marginal cost of production and the socially optimal price. Welfare is maximized under market forces (Pareto optimum) and government interventions only distort efficient resource allocation by creating a wedge between the marginal cost price and the socially optimal price"*[9]. Indeed, in a world where markets are full of competitors and well-informed abundant consumers, where there are no barriers to entry and thus competition provides the perfect interaction of supply and demand, a governmental intervention is, in principle not necessary. But the reality is that this situation does not occur and, in consequence, governments have to correct or enhance the dynamics within a market.

2.2 Market Failure

Markets tend to reproduce the economic behaviour of participants, namely consumers and producers. Nonetheless, what a market *prima facie* will not express is that in certain situations benefits and costs may be borne by a person different from that who creates it (in the energy industry, for example, producers of fossil fuel energy do not tend to internalise the cost of polluting the environment[10]). In effect, "*positive or negative externalities (also called 'spill overs') are, respectively, benefits or costs resulting from consumer or producer actions that are not reflected*

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[7] WTO Secretariat (2006), p. 47.
[8] There are two main ways in which a government can intervene in a market: through fiscal or non-fiscal measures. The first group refers essentially to taxes and subsidies; the second ones are technical regulations, for instance. See: Coppens, Dominic (2015), p. 50.
[9] Coppens, Dominic (2015), p. 51.
[10] Howse, Robert (2014), p. 4.

in the market price and, thus, external to the market. Such marginal external benefits or costs can be internalized by government intervention in a way that the new market price equals the socially optimal price"[11]. In these events, a government may use a subsidy to correct such an externality (which agglutinates the various situations of market failures), either by providing a consumer-based subsidy (one that is given so that the consumer can have an extra available income and counteract the effect of the marginal cost created by the externality) or a producer-based subsidy (which consists in a financial contribution so that the producer can maximize its output without the negative the externality caused upon its production).

2.3 The Profit-Shifting Rationale

There are certain markets that developed, from their beginnings, as concentrated markets due to various reasons (research and development may have been available to a limited number of players or the huge amounts of capital investment needed for starting certain projects might have reduced the possibilities to entry). In the context of globalization, whole markets might be controlled by foreign enterprises or have very little participation of domestic companies. In this context, subsidies can be used towards redistributing the participation of these market shares into more competitors (diffusion of participation)[12]. The aforementioned can have some benefits to the society as a whole: (i) By reducing barrier to entry, more participants can translate to more competition and better products, (ii) by having more participation of different producers, prices tend to lower to the benefit of consumers which will have more income available. Nevertheless, Krugman argues that this policy decision may not be the most suitable so long as governments are

[11] Coppens, Dominic (2015), p. 52.
[12] Coppens, Dominic (2015), p. 52.

usually unable to define the extent of efficient subsidisation, thus incurring in huge costs that tend to disperse in all the population causing more 'evil than good'[13].

2.4 The Counterpart –Subsidies from a Political Economy Perspective

Subsidies appear to be 'good' in a very simple world, such as the one previously described. In reality, markets are immersed in the global economy, governments are subject to human people with lots of contradictory interests and information or knowledge is imprecise when identifying the exact extent of subsidies programs. This is why there is a discipline that prohibits subsidies on a multilateral level (WTO). Indeed, subsidies tend to distort more than they actually help.

Subsidies start by a governmental action. This intervention is subject, on its nucleus, to multiple interests, which includes the bias that public servants have towards increasing their stay in power (specially presidents for re-election). Indeed, as Sykes states, "*The political-economy literature does not start from the assumption that decision-makers aim at maximizing the welfare of their constituencies, but instead assumes that politicians aim at maximizing their own welfare (self-interest), which is often modelled in terms of maximizing their chances of (re-election). The outcome of the decision-making process, for example on offering subsidies, therefore, depends on its effect in the political 'marketplace'*"[14].

What is the effect in reality? Subsidies do not tend to reach the hands of efficient recipients but of those that support a determinate political candidate and are sectors traditionally inefficient. Subsidies are associated with protectionism, which economically is a very inefficient system (so long as it makes sectors inefficient and consumers tend to pay its cost). As Coppens states: "*In reality, however, the opposite situation seems to happen more frequently: the more benefits are*

[13] Krugman, Paul (1993), pp. 363-4.
[14] Sykes, A. O. (1991), p. 275.

concentrated and the more costs are diffused, the more likely that promotion or protection is given."[15]

2.5 Implementation of Subsidy Programmes

Theory and practice do not tend to go always in the same direction. Even though a government might have good intentions in correcting a market failure, its action can be misleading. As the WTO Secretariat puts it, "*identifying the precise cases where intervention is socially desirable is not easy. The information requirements for appropriate interventions are extremely high, thereby making the possibility of mis-timed and mis-targeted intervention high. These implementation issues are called "government failures"*[16]. And continues, "*even if subsidy programmes correctly identify beneficiary industries and firms, achieving the predicted economic effect is not necessarily assured. All of the cases examined above assume that a subsidy will generate a supply response. Sometimes, however, firms may receive the subsidy, but may not necessarily use the subsidy commercially"*[17].

2.6 The Distortive Effects to Trade

Until here, subsidies are analyzed mainly from a national or domestic standpoint. Nonetheless, subsidies are very distortive on an international trade standpoint, which is precisely the situation that justifies the existence of the SCM Agreement (a detailed explanation is given in section 2). Preliminarily this poses a very difficult tension: While subsidies can be paramount towards achieving policy goals important for States, they tend to be very distortive on the international level, to the prejudice of consumers even within the State that implements the subsidy. This leaves

[15] Coppens, Dominic (2015), p. 54.
[16] WTO Secretariat (2006A), p. 63.
[17] *Ibid.*, p. 63.

the question of "policy space" that States have to pursue legitimate goals but without harming trade interests of other Nations.

Indeed, as Van den Bossche states, "*On the one hand, subsidies are evidently used by governments to pursue and promote important and fully legitimate objectives of economic and social policy. On the other hand, subsidies may have adverse effects on the interests of trading partners whose industry may suffer, in its domestic or exports markets, from unfair competition with subsidised products*"[18]. Or, as Gehring, Hepburn and Cordonier affirm, "*governments are sometimes tempted to support domestic producers by granting them financial incentive in the form of subsidies on their production. These subsidies help to make the domestic producers more competitive by allowing them to sell their goods in local or foreign markets at cheaper price. However these subsidies can also hurt foreign producers and distort international trade*"[19].

3. SUBSIDIES –INTERNATIONAL TRADE PERSPECTIVE

The SCM Agreement disciplines subsidies from an international perspective since 1995, after the Uruguay Round. This treaty, which is part of the Marrakesh Agreement (the architecture of the whole multilateral trading system), disciplines subsidies in goods (subsidies in services is still a discipline that remains unregulated). In fact, the AB in *US- Countervailing Duties Investigation on DRAMS* has established that: "*the object and purpose of the SCM Agreement is to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures*"[20]. In order to fully comprehend the subsidies discipline, we will divide this section into two parts: In the first one we will provide of a brief historical overview of the SCM Agreement in

[18] Van den Bossche, Peter (2008), p. 745.
[19] Gehring, M., Hepburn, J. & Cordonier, M. C. (2006), p. 77.
[20] ABR, *US- Countervailing Duties Investigation on DRAMS,* para. 115; ABR, *US-Antidumping and CVD (China),* para. 561.

order to understand how the international trade discipline arrived to the actual regulation and in a second part we will explain the fundamentals of the SCM: The definition of subsidies and their classification.

3.1 Historical Overview of Subsidies Disciplines

3.1.1 GATT 1947

After the Second World War, governments were concerned with constructing multilateral institutions that would prevent war from breaking again. In line with this, they constructed three main organizations that provided to deepen the economic interdependence between states: (i) The World Bank, (ii) the International Monetary Fund and (iii) the International Trade Organization. The last one was, nonetheless, nothing similar to what the WTO looks like. It was only composed by disciplines regarding trade in goods, the famous GATT 1947.

Regarding subsidies, "*both countries [the United States and the United Kingdom that where the driving forces of the negotiations] had defended 'diametrically opposed' views: the United States wished to phase out domestic (agriculture) subsidies but preserve export subsidies, whereas the United Kingdom pushed for the opposite. As a compromise more in line with the United Kingdom's position, the Suggested Charter stipulated (i) procedural requirements on all trade-affecting subsidies; and (ii) a prohibition on export subsidies (over a three-year period), except under circumstances of burdensome world surplus in a product. (...) In the end, the Havana Charter disciplined subsidies largely along the same lines as those suggested by the United States and the United Kingdom: (i) trade-affecting subsidies had to be notified and their limitation had to discussed if they caused serious prejudice to other members; and (ii) export subsidies were prohibited (over a two-year period), except for primary commodities, for which they were in*

essence only prohibited when leading to a 'more than equitable share of world trade'"[21]. As the reader can see, the disciplines on subsidies were incipient since not even a definition of subsidy was given, thus making the task of identifying the scope of application of GATT Article XVI very difficult.

3.1.2 The 1954–1955 Review Session and the 1960 Declaration

The unique paragraph that was included in GATT Article XVI provided no express substantial obligation to the Members since it was only an obligation to notify the other Member of the product subject to a subsidy and the correlative importance of doing so. This, of course, was of little utility[22]. Thus, in 1954 Review Session, countries were aware of the necessity of imposing additional obligations regarding subsidies, at least for non-primary products.

The result of the negotiations was a clear bifurcation between primary and non-primary products; however, substantive obligations did emerge. Furthermore, the 1960 Declaration provided an illustrative list of prohibited subsidies, which has been kept until our days with some amendments. In sum "*regarding primary products, paragraph 3 of GATT Article XVI only provided for an obligation to 'seek to avoid' the use of export subsidies (...). Regarding non-primary products, contracting parties had, from 1958 or 'the earliest practicable date thereafter', to cease to grant export subsidies when they resulted in a sale at a price for export lower than that for the domestic market (bi-level pricing test) (GATT Article XVI:4). Only in 1960 were contracting parties able to agree on a Declaration Giving Effect to the Provisions of Article XVI:4 (1960 Declaration), which elaborated a non-exhaustive list of export subsidies on non-primary goods. A general definition of*

[21] Coppens, Dominic (2015), p. 64.
[22] *Ibid.*, p. 65.

'subsidy' was thus still lacking, but an illustrative list of prohibited export subsidies was agreed on"[23].

3.1.3 Tokyo Round: Subsidies Code

In the 70's decade, several countries -particularly Japan and the European countries- felt the need to discipline non-tariff barriers, specially subsidies and countervailing duties[24]. In specific, the United States consistently was imposing countervailing duties without a material injury test, which placed countries that were enjoying an increase in production and exportation in serious competitive difficulties. The Tokyo Round faced these difficulties and after many negotiations, the Tokyo Subsidies Code was ratified in 1980 by 24 countries (mainly developed countries because developing countries still were reluctant towards accepting substantive obligations by opposing the 'infant industry' argument[25]). The biggest development of the Tokyo Subsidies Code was that is enhanced the disciplines over non-primary subsidies and proving a clear material injury test for applying a countervailing duty. Nevertheless, this success was counteracted by the very little participation of other countries, which were unwilling to commit themselves to this new approach towards non-tariff restrictions.[26]

3.1.4 The Uruguay Round of 1986

The 80's were a difficult decade since recession was the general rule and very little growth was visible. As a consequence, many countries used fiscal expense in the form of subsidies to reactivate certain sectors of the economy; this was particularly true with the steel industry. Nonetheless, the

[23] *Ibid.*, p. 66.
[24] Croome, John (1999), p. 60.
[25] This argument provides that indsutries have phases, such as the human life. When they are emerging it is imposible that they can compete with 'adult' industries that have been developing for many years. In this scenario, subsidies tend to strengthen the basis of 'infant industries' until they are strong enough to compete.
[26] Coppens, Dominic (2015), p. 67.

Subsidies Code panels were unable to face these realities and when the Uruguay Rounds were launched in 1986, the subsidies issue was one of the first that were brought up by countries. Coppens states "*Next to pleading for more stringent multilateral disciplines, the United States unilaterally stepped up the imposition of CVDs and anti-dumping duties in response to foreign 'subsidization' and dumping, and the scope of both laws was amended to facilitate their imposition. Because the Subsidies Code lacked a subsidy definition, all kinds of government interventions (and even private interventions) which (potentially) distort trade could be countervailable, as was in theory the case under US law. Hence, by urging a narrow subsidy definition and the inclusion of a specificity test, the EU and other countries aimed to curtail the coverage of these CVD laws. The inclusion of a subsidy definition in the SCM Agreement was therefore generally considered to represent one of the most important achievements of the Uruguay Round in the area of subsidy disciplines*"[27]. Furthermore, the whole discussion between agricultural and non-primary goods was ended with the signing of the Agreement of Agriculture, which disciplined subsidies in a manner that was consistent with the needs of developing countries. At the end the SCM Agreement was included as an annex to the disciplines in trade in goods, with provisions regulating: (i) the scope of application of the provisions, (ii) a clear classification of subsidies and (iii) procedural disciplines for countervailing measures, among others.

3.1.5 Doha Round Negotiations

The Doha Rounds, launched in 2001, promoted the review of different trade regulations, included subsidies. Specifically, the matters that were discussed regarded the agricultural subsidies since it was proposed by developing countries to change provisions towards a development-based concept. These negotiations have been unsuccessful since not many consensuses have been reached.

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[27] *Ibid.*, p. 68.

3.2 Definition and Classification of Subsidies

3.2.1 Definition and Elements of a Subsidy

According to article 1.1 of the SCM Agreement a subsidy is: (i) a financial contribution, (ii) provided by a government or any public body within the territory of a Member, (iii) which confers a benefit upon its recipient. Each and every element must be present if a measure is to be characterized as a subsidy. The scope of application of the SCM is, thus, subject to the compliance of the three prerequisites, which are applied cumulatively. Specificity, according to article 1.2 of the same agreement, is also a requisite if a complainant is trying to challenge a measure. Nonetheless, the analysis of specificity will vary if a complainant brings a claim under Part III of the Agreement or pursuant to Part II of the same agreement, as it will be explained. Indeed, specificity is not a nuclear requisite of subsidies but, rather, a necessary element that the SCM provides, so long as a subsidy exists only with the proof of its three nuclear elements; specificity is a requisite for its challenging (since it is associated with the distortive effects of the subsidy in the particular market that is being subject to analysis).

3.2.1.1 'Financial contribution'

As stated above, a subsidy within the meaning of the SCM Agreement exists if three distinctive elements are present: "*(i) a financial contribution (ii) by a government (or any form of income or price support in the sense of Article XVI of the GATT); and (iii) a benefit is thereby conferred*"[28].

Article 1.1(a)(1) provides the first element of a subsidy: A *financial contribution.* The evaluation of the existence of a financial contribution implies the consideration of "*the nature of the transaction through which something of economic value is transferred by a government*"[29]. A wide

[28] Article 1.1 of the SCM Agreement.
[29] ABR, *US- Softwood Lumber IV*, para. 52.

range of transactions falls within the meaning of "*financial contribution*". This can include transactions or situations, such as:

- When a government practice involves a direct transfer of funds (eg. a grant, loan or equity infusion) or a potential transfer of funds (example a loan guarantee).
- When governments revenue that would normally be due is not collected (eg. a tax credit)
- When a government purchases goods or provide goods or services apart from general infrastructure.
- When a government directs a private body to undertake any of activities above.[30]

The AB has explained the following about the former list: "*The listed items are not mutually exclusive. However a transaction may fall under more than one type of financial contribution (or also be covered as income or price and support). As the characterization of the measure could have a bearing on the assessment of the benefit*"[31], hence different aspects of the same transaction could fit under different types of financial contribution.

The previous list, although provides for exhaustive characterization, is complemented by the provision in article 1.1(a)(2) that expands the array of situations that capture the shifting of an asset or something of economic value. Indeed, this provision states that a financial contribution is also "*(...) any form of income or price support in the sense of Article XVI of GATT 1994*". This provision provides a more ample scenario of situations in which a government might try to place the recipient in a more advantageous position[32]. Furthermore, it is worth noting that article

[30] Article 1.1 of the SCM Agreement.

[31] ABR. *Canada- Renewable Energy,* paras. 5.120-5.130.

[32] The AB has understood that this provision expands the array of scenarios that a complainant might pursue to characterize a measure as a financial contribution. Indeed, in *US- Softwood Lumber IV,* the AB established: "*An evaluation of the existence of a financial contribution involves consideration of the nature of the transaction through which something of economic value is transferred by a government. A wide range of transactions falls within the meaning of "financial contribution" in Article 1.1(a)(1). According to paragraphs (i) and(ii) of Article 1.1(a)(1), a*

1.1(a)(2) provides a clear reference to article XVI of the GATT, thus confirming that the SCM Agreement imposes additional disciplines for subsidies but without disregarding the application of GATT Article XVI. This issue is important since it provides of important contextual elements in order to answer the question if GATT Article XX may be applicable to defend a respondent towards breaches of obligations existent in the SCM[33].

3.2.1.2 'By a Government or any public body within the territory of a Member'

An essential element to prove that a measure is a subsidy under the meaning of article 1.1 of the SCM Agreement is that the government should make the financial contribution, either the government in the narrow sense (President and its ministries) or government in the broad sense ('public bodies'). "*The contribution could be made where directly by the government 'in the collective sense', which covers the government 'in the narrow sense' as well as 'any public body' within the territory of a member. Alternatively, financial contributions offered by a private body could be indirectly attributed to the government through demonstration of entrustment or direction of that body by the government in the narrow sense or by a public body*"[34].

In the first event, the government or "any public body" makes the financial contribution directly. Indeed, the AB has emphasized that the correct interpretation of article 1.1(a)1 of the SCM Agreement is one where a "public body" is an entity that "*possesses, exercises or is vested with governmental authority*"[35]. The previous statement provides that control exercised by the

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financial contribution may be made through a direct transfer of funds by a government, or the foregoing of government revenue that is otherwise due. Paragraph (iii) of Article 1.1(a)(1) recognizes that, in addition to such monetary contributions, a contribution having financial value can also be made in kind through governments providing goods or services, or through government purchases. Paragraph (iv) of Article 1.1(a)(1) recognizes that paragraphs (i)–(iii) could be circumvented by a government making payments to a funding mechanism or through entrusting or directing a private body to make a financial contribution. It accordingly specifies that these kinds of actions are financial contributions as well. <u>This range of government measures capable of providing subsidies is broadened still further by the concept of "income or price support" in paragraph (2) of Article 1.1(a)</u>." (Highlights outside of original text). ABR, *US — Softwood Lumber IV*, para. 52.

[33] This discussion is addressed on chapter 3.3 of the Written Submision, found on Section III of this paper.

[34] Coppens, Dominic (2015), p. 90.

[35] ABR, *US-Antidumping and Countervailing Duties* (China), paras. 317-318.

government towards the relevant entity is not sufficient to infer that it is a public body[36]. The determination of a public body is not always an easy task, the AB has recognized[37]. The interpreter must infer the nature of the entity taking into consideration that sometimes the entity may have elements that point out to the situation that it is a public body, whilst other point in the opposite direction. The important factor is whether it exercises authority, which can be inferred from different elements: (i) Delegation of authority in its by-laws, (ii) majority ownership, and (iii) the exercise of governmental functions[38], amongst others.

Alternatively, when no direct action by the government is found in the factual scenario, a financial contribution may be provided indirectly by a government, this is when a private body is being used (entrusted or directed) as a proxy by the government to carry out functions provided in sub-paragraphs (i) to (iii) of article 1.1(a)1 of the SCM Agreement. This situation, according to the AB, is helpful to "*identify the instances where seemingly private conduct may be attributable to a government for purposes of determining whether there has been a financial contribution within the meaning of the SCM Agreement*"[39]. In essence, the provision in article 1.1(a)1(iv) of the SCM

[36] This was the case in *Korea-Commercial Vessels.* The complainant argued that since the Banks in Korea where subject to the control of the government, the financial contributions it gave to the private recipients was enough to conclude that the government was using the funds of the Banks as their own and, hence, it was a public body within the meaning of article 1.1 of the SCM Agreement.

[37] "*We see the concept of "public body" as sharing certain attributes with the concept of "government". A public body within the meaning of Article 1.1.(a)(1) of the SCM Agreement must be an entity that possesses, exercises or is vested with governmental authority. Yet, just as no two governments are exactly alike, the precise contours and characteristics of a public body are bound to differ from entity to entity, State to State, and case to case. Panels or investigating authorities confronted with the question of whether conduct falling within the scope of Article 1.1.(a)(1) is that of a public body will be in a position to answer that question only by conducting a proper evaluation of the core features of the entity concerned, and its relationship with government in the narrow sense.*
In some cases, such as when a statute or other legal instrument expressly vests authority in the entity concerned, determining that such entity is a public body may be a straightforward exercise. In others, the picture may be more mixed, and the challenge more complex. The same entity may possess certain features suggesting it is a public body, and others that suggest that it is a private body". ABR, *US — Anti-Dumping and Countervailing Duties (China)*, paras. 317–318. (Highlights outside of original text)

[38] This is one of the most important factors according to the AB in *US.Carbon Steel (India),* para. 4.150

[39] ABR, *US – Countervailing Duty investigation on DRAMS,* para 108.

is useful towards preventing that States circumvent their obligations under the treaty in prejudice of other Members[40].

3.2.1.3 'Benefit'

To consider a financial contribution granted by the government as a subsidy within the meaning of the SCM Agreement, it must confer a benefit upon the beneficiary or recipient. "*The benefit element should be clearly distinguished from the 'financial contribution' component. Whereas the financial contribution element focuses on the government, in the determination of a 'benefit' the focus shifts towards the recipient of the contribution*."[41]

Furthermore, "*numerous dispute settlement reports confirm that a financial contribution confers a 'benefit' if it is provided to the recipient on terms more favourable than the recipient could have obtained from the market*."[42] Hence, the benefit concept is defined by reference to the market. This one, in turn, is defined by the AB "*as 'the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices*"[43]. Private market prices that are effectively available to the recipient should be used as the relevant point of reference: Would the recipient operating in its particular market be worse off absent the government contribution? Hence 'benefit' in the meaning of the SCM Agreement is a 'market-based concept'.[44] Having this in mind, "*the benchmark must indeed reflect conditions in the market absent the contribution*"[45].

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[40]Article 1.1(a)1(iv) of the SCM "*is intended to ensure that governments do not evade their obligations under the SCM Agreement by using private bodies to take actions that would otherwise fall within Article 1.1(a)(1), were they to be taken by the government itself. In other words, Article 1.1(a)(1)(iv) is, in essence, an anti-circumvention provision"*. Appellate Body Report, *US — Countervailing Duty Investigation on DRAMS*, para. 113.

[41] Coppens, Dominic (2015), p. 95.

[42] ABR, *Canada –aircraft* .paras. 154,-157.

[43] ABR, *EC- large Civil Aircraft*, para. 1122.

[44] Coppens, Dominic (2015), p. 97.

[45] ABR, *EC- large Civil Aircraft,* para. 900.

3.2.1.4 Specificity

The SCM Agreement only applies to subsidies that are specific. "*The basic principle is that a subsidy that distorts the allocation of resources within an economy should be subject to discipline. Where a subsidy is widely available within an economy, such a distortion in the allocation of resources is presumed not to occur. Thus, only 'specific' subsidies are subject to the SCM Agreement disciplines*"[46]. This concept, although not defined specifically in the SCM Agreement, can be inferred from the principles set out in subparagraphs (a) to (c) of article 2.1. The important point, nonetheless, is that a subsidy is directed to benefit an enterprise, a group of enterprises, an industry or a group of industries[47]. Hence, a subsidy is deemed to be specific when it is available only to a determinate recipient (enterprise, enterprises, industry or group of industries), which means that the granting authority "*explicitly limit access to that subsidy to eligible enterprise or industry*" [48]. A subsidy is not considered specific if there are objective criteria for the eligibility: "*It must be automatic and the criteria must be strictly adhered to for the subsidy not to be considered specific*" [49].

Specificity can be of two categories: (i) *De iure* specificity, this is, when the legislation pursuant to which the granting authority operates explicitly limits the giving of the subsidy to certain enterprises (principles laid down in subparagraphs (a) and (b) of article 2.1 of the SCM); or (ii) *de facto* specificity, this is, when there is not a legal instrument excluding certain enterprises of the subsidy but there are in fact reasons to infer from reality that this is the case occurring. The AB, in

[46] WTO, "*Subsidies and Countervailing Duties: an Overview.*" Available in the internet: https://www.wto.org/english/tratop_e/scm_e/subs_e.htm (last retrieved: October 20 2016).
[47] Article 2.1 of the SCM Agreement "*In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority), (...)*".
[48] ABR, *US-Antidumping and Countervailing Duties* (China), paras. 365-366.
[49] Gehring, M., Hepburn, J. & Cordonier, M. C. (2006), p. 78.

fact, has established that "*if there are reasons to believe that the subsidy may in fact be specific, other factors may be considered*" [50]. These factors include:

- Predominant use of a subsidy programme by certain enterprise
- Disproportionally large grants to certain enterprises

Furthermore, it is worth noting that any subsidy in the "red light" category of prohibited subsidies is automatically considered to be specific by virtue of article 2.3 of the SCM Agreement. Once the complainant has established that the subsidy is prohibited within the meaning of article 3.1 of the SCM it is given that it is specific.

3.2.2 Classification of Subsidies

3.2.2.1 Prohibited subsidies

The SCM Agreement develops the concept of prohibited subsidies in Part II of the Agreement. Article 3.1(a) of the SCM agreement establishes that subsidies contingent in law or in fact, whether solely or as one of several other conditions, upon export performance, are prohibited. It means that the granting of the subsidy "*require*[s] *certain level of export earnings before the subsidy is granted*"[51]. On the other hand, article 3.1(b) of the same agreement disciplines "*subsidies that are contingent on the use of domestic rather imported goods*". In the case of export contingent subsidies, footnote 4 sets the standard for determining when a subsidy is 'tied to' actual or anticipated exportation in the case of *de* facto export contingent subsidies[52]. Subsidies contingent upon the use of domestic over imported goods do not provide a similar regulation, but the AB has

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[50] PR, *US- Softwood Lumber IV*, para. 7.123.
[51] Gehring, M., Hepburn, J. & Cordonier, M. C. (2006), p. 79.
[52] ABR, *US –FSC,* para. 111.

been emphatic towards concluding that these subsidies can also be *de facto* contingent, thus equating both standards for prohibited subsidies[53].

But, why are Prohibited Subsidies so feared in international trade? Subsidies that fall under the scope of the article 3 of the SCM Agreement are prohibited "*because they are specifically designed to distort international trade, and are therefore likely to hurt other countries trade*"[54]; for that reason "*if the prohibited subsidy is not immediately removed following the dispute resolution procedure the complaining WTO member is allowed to take countervailing measures (by imposing, for example, a special duty on the goods being subsidized) in order to avoid the negative effect of the subsidy)*"[55]. Indeed, economists have insisted that these kinds of subsidies tend to be the most distortive of all as they have a double effect: (i) Inside the Member's market (the granting State) the subsidized good tends to become scarce (either by giving an incentive to producers in order to export it or by preventing imports of the same good) therefore rising its price in prejudice of consumers; (ii) outside the Member's market the subsidized goods tend to inundate foreign markets in prejudice of foreign producers that cannot compete with the financial muscle of the government that grants the subsidy[56].

3.2.2.2 Actionable subsidies

This category of subsidies is disciplined by part III of the SCM Agreement and has been catalogued as "amber light" subsidies. According to previous explanation, "*any specific subsidy within the meaning of Articles 1 and 2 of the SCM Agreement is potentially actionable. This means that such amber light subsidies can be subject to multilateral action if they cause 'adverse effects' to the*

[53] ABR, *Canada — Autos*, paras. 139–143.
[54] WTO, "*Subsidies and Countervailing Duties: an Overview.*" Available in the internet: https://www.wto.org/english/tratop_e/scm_e/subs_e.htm (last retrieved: October 20 2016).
[55] Gehring, M., Hepburn, J. & Cordonier, M. C. (2006), p. 79.
[56] Coppens, Dominic (2015), p. 51.

interests of other members"[57]. Hence, subsidies may or may not be actionable or permitted depending on their effect on the interests of other WTO member. According to article 5 of the SCM agreement such effects could be:

- Injury to another member's domestic industry
- Nullification or impairment of benefits occurring directly or indirectly to another member under GATT 1994.
- Serious prejudice to another Member's interest.

One of the most important effects is that a specific subsidy may cause 'serious prejudice' to another's member interests. Such serious prejudice effect is developed by article 6.3 of the SCM Agreement. This article provides that serious prejudice occurs when at least one of the following market phenomena has been demonstrated:

- Displacement or impedance of the imports of a like product of another Member into the market of the subsidizing Member;
- Displacement or impedance of the exports of a like product of another Member from a third country market;
- Significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market;
- Increase in the world market share of the subsidizing Member in a particular "*subsidized primary product or commodity as compared to the average share it had during the*

[57] *Ibid.*, p. 179.

> *previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted*"[58].

Furthermore, it is fundamental for a complainant to succeed in its claim under article 6.3 to prove the causation standard. The AB has established in numerous reports that there should be a "*genuine and substantial relationship of cause and effect' between the subsidies and the alleged market phenomena*"[59]. This means, in a negative formulation, that the market phenomenon would not have occurred *but for* the subsidy, this is, that by suppressing the subsidy from the causal chain, the phenomena would not have occurred.

3.2.2.3 Non-Actionable subsidies

These kind of subsidies has been catalogued as "green light subsidies" since Members of the WTO are available to maintain these kind of subsidies as they do not cause adverse effects to the interest to another member, or they are permitted since a legitimate purpose is pursued. The SCM Agreement only disciplines subsidies that are specific, "*therefore, any form of government assistance that is not classified as a subsidy is naturally not covered by the SCM Agreement and so is allowed, as is any subsidy that is not classified as specific*"[60].

Article 8 of the SCM Agreement regulated other kind of non-actionable subsidies (associated with research and development, infrastructure, etc.); however, these provisions expired in 1999 because *"the SCM Agreement provided for a notification requirement for such non-actionable subsidies, but no single formal notification was made over the entire period that this category was in place*"[61].

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[58] Article 6.3(d) of the SCM Agreement.
[59] ABR, *US- Large Civil Aircraft,* para. 913; and ABR, *EC – Large Civil Aircraft*, paras. 1232, 1233, 1376.
[60] Gehring, M., Hepburn, J. & Cordonier, M. C. (2006), p. 80.
[61] Coppens, Dominic (2015), p. 204.

Therefore, as expiration has operated, "*the type of subsidies defined there are actionable and open to challenge if they cause an adverse effects of another member's international trade*"[62].

4. Case Study: *Canada-Renewable Energy*

The *Canada-Renewable Energy* case, adopted by the DSB in 2013, addresses the compatibility of renewable energy policy measures with the WTO obligations, and in particular with the disciplines on subsidies contained in the SCM Agreement. Although Japan and the European Union won their case against Canada in both instances in their claims about the violations of the non-discrimination disciplines laid out in the General Agreement on Tariffs and Trade (GATT) and the Agreement on Trade-Related Investment Measures (TRIMS Agreement), the AB held that it was unable to complete the legal analysis as to the claims pursuant to the SCM agreement. Even though some authors celebrate the significant addition to WTO Jurisprudence, others qualify it as "*bad law*"[63], and point out that new disputes arising from renewable energy issues "*will almost surely continue to occur*"[64]. It has also been commented that the AB incurred in "*legal acrobatics*"[65] in order to avoid finding that the policy measure was a subsidy, with a view to promote –or at least to not detain- State measures that encourage the development of green energies[66].

In this chapter, we will provide a brief summary of the facts and analyze the main issues raised by the case, related to the SCM Agreement.

[62]*Ibid.*, p. 80.
[63] Rubini, Luca (2015), p. 211.
[64] Charnovitz, S., & Fischer, C. (2015), p. 179.
[65] Rubini, Luca (2015), p. 211.
[66] Cosbey, A. & Mavroidis, P. C. (2014), p. 1.

4.1 The Facts of the Case[67]

The government of Ontario, Canada, attempting to diversify its energy industry, implemented since 2004 different acts to consolidate a "supply mix" system of sources of energy, this is, a system composed of sources of electricity generated by different technologies (wind, solar, tidal, carbon, etc.). Nevertheless, because of the absence of investment by private parties, the government of Ontario decided to strongly intervene in the market. In this context, in 2009, the government launched the Feed-in Tariff Program (FIT) and the MicroFit program seeking to incentivize the production of electricity from wind or solar generators, which included a scheme to source a minimum level of the component parts and services from the producers within Ontario. These FIT programs were long-term contracts by a government agency to secure wholesale electricity at a fixed price that would reflect an attractive rate of return to investors, securing therefore a price above the wholesale electricity price[68].

These measures were challenged by Japan and the European Union before the Dispute Settlement System of the WTO. Both complainants claimed that the challenged measures were inconsistent with articles 3.1(b) and 3.2 of the SCM Agreement, Article 2.1 of the TRIMS Agreement, and Article III:4 of the GATT.

4.2 The Ruling of the Panel

As regards to the claims under the SCM Agreement, the Panel determined that the appropriate legal characterization of the FIT scheme was a financial contribution in the form of government "purchases of goods" within the meaning of Article 1.1(a)(1)(iii) of the SCM Agreement[69],

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[67] Further information about the factual aspects of this dispute is set forth in greater detail in: PR, *Canada-Renewable Energy,* paras. 2.1, 7.9-7.68.

[68] Charnovitz, S., & Fischer, C. (2015). p. 179.

[69] PR, *Canada-Renewable Energy,* para. 7.222.

rejecting the possibility that it could also be legally characterized as "direct transfer of funds"[70], "potential direct transfer of funds" under subparagraph (i) or a form of financial contribution involving government entrustment or direction within the meaning of subparagraph (iv) of article 1.1(a)(1)[71]. Having determined the foregoing, the Panel examined whether it conferred a benefit, within the meaning of Article 1.1(b), and in this context concluded that there could be only one relevant market for the purpose of the benefit analysis, namely, the market for electricity generated from all the sources of energy, including solar and wind energy[72].

However, the Panel found the following in respect of such market in Ontario: "*the wholesale electricity market that currently exists in Ontario is not a market where there is effective competition. Rather, Ontario's wholesale electricity market is perhaps better characterized as a part of an electricity system that is defined in almost all aspects by the Government of Ontario's policy decisions and regulations pertaining to the supply mix needed to ensure that Ontario has a safe, reliable and long-term sustainable supply of electricity, as well as how the costs of that system will be recuperated"*[73].

Having rejected such market, and other markets proposed by the complainants, the Panel found that the complainants had failed to establish the existence of benefit, and made its own suggestion as to what it considered could be an appropriate benchmark in those circumstances: "*testing* [the FIT prices] *against the types of arm's length purchase transactions that would exist in a wholesale electricity market whose broad parameters are defined by the Government of Ontario"*[74]. However, it noted that the record of the dispute did not contain any appropriate information.

[70] PR, *Canada-Renewable Energy,* para. 7.243.
[71] PR, *Canada-Renewable Energy,* para. 7.248.
[72] PR, *Canada-Renewable Energy,* para. 7.318.
[73] PR, *Canada-Renewable Energy,* para. 7.308.
[74] PR, *Canada-Renewable Energy,* para. 7.322.

Hence, the Panel concluded that the complainant had failed to establish that the FIT Programme constituted subsidies, or envisaged granting a subsidy, within the meaning of article 1.1 of the SCM Agreement.

4.3 The Ruling of the Appellate Body

In relation with the SCM Agreement, the AB Report was focused mainly on the benefit analysis[75], but in particular it dealt with two elements that relate to that analysis: The definition of the relevant market, and the government intervention on that market. Accordingly, these two elements will be analyzed ahead:

4.3.1 The Relevant Market

In reviewing the appeal against the Panel report, the AB examined thoroughly the definition of the relevant market, and found two main inconsistencies in the report: i) It considered that the Panel should have started, rather than concluding, its benefit analysis with the definition of the relevant market[76], and ii) that in defining the relevant market, the Panel did not consider additional factors –besides demand side substitutability- on the demand and supply side[77].

As to the first concern, it stated: "*The definition of the relevant market is central to, and a prerequisite for, a benefit analysis under Article 1.1(b) the SCM Agreement*"[78], posing an innovative requirement that ensures that a full market analysis is performed at the benefit analysis, and not later[79]. As the underlying reason for this statement, it argued that "*the existence of a benefit can properly be established only by comparing the prices of goods and services in the relevant market where they compete*", and that "*it would seem logical for a panel that is tasked with a*

[75] Article 1.1(b) of the SCM Agreement.
[76] ABR, *Canada-Renewable Energy*, paras. 5.169-5.170.
[77] *Ibid.*, para. 5.170.
[78] ABR, *Canada-Renewable Energy,* para. 169.
[79] Rubini, Luca (2015), p. 220.

benefit determination to begin its analysis by defining the relevant market, which will be used for the purposes of undertaking the benefit analysis"[80].

In relation with the second concern, the AB argued that there were additional factors that could be used to differentiate on the demand-side, which the Panel did not consider in its analysis of the relevant market. Factors such as the type of contract, the size of the customer, and the type of electricity generated (base-load versus peak-load) may differentiate the market[81]. In doing so, the ruling was based on the presumption that governments, as consumers, view renewable energy products as different from conventional generation[82].

Also, based on the case *EC and certain member States-Large Civil Aircraft*[83]*,* it remarked that supply-side factors are highly relevant in the definition of the relevant market[84]. In accordance with this line of reasoning, it ascertained that if the Panel had undertaken a complete analysis of all the relevant factors in the definition of the relevant market, and in particular of supply-side factors, "*the significance of government intervention in the electricity market to the definition of the relevant market would have become evident*", and the Panel would have reached different conclusions such as that the wholesale electricity market was not the appropriate focus[85]. Taking into consideration these remarks, it can be noted that the decision distinguishes between electricity from certain renewable energy sources and other generation, "*which is an important development as the electrical current from the two sources is physically identical and interchangeable in use*"[86].

[80] ABR, *Canada-Renewable Energy,* para. 5.169.
[81] *Ibid.*, para. 5.170.
[82] Charnovitz, S., & Fischer, C. (2015), p. 195.
[83] ABR, *EC-Large Civil Aircraft*, para. 1121.
[84] ABR, *Canada-Renewable Energy*, para. 5.171.
[85] *Ibid.*, para. 5.172.
[86] Charnovitz, S., & Fischer, C. (2015), p. 188.

Besides these concerns, the AB made some additional commentaries about the markets of electricity. It stated that it must be taken into account that some markets –such as wind and PV generated electricity- can only come into existence as a matter of government regulation and that, in fact, it is often the supply mix of the governments that creates markets for this kind of electricity, due to the high cost structures and operating costs of these technologies that prevent them from competing satisfactorily in the market[87].

Hence, the AB came to a preliminary conclusion, which was that "*the definition of a certain supply-mix by the government cannot in and of itself be considered as conferring a benefit within the meaning of Article 1.1(b) of the SCM Agreement*"[88]. It also concluded that the Panel not only should have defined the relevant market at the beginning of the benefit analysis, but also should have considered that the government definition of the energy supply-mix shapes the markets in which generators of electricity through renewable technologies compete. In this sense, even though the AB admitted that introducing legitimate policy considerations into the determination of benefit could not be reconciled with the SCM Agreement, it did not exclude considerations about the creation of markets by governmental intervention for the purpose of defining the relevant market[89].

This point of the definition of the relevant market has been subject to a volume of commentaries, mainly critic. Certain reviewers celebrate the final product market that resulted of the AB analysis, although stating that the reasons were not "*cogent*"[90], while the majority of commentators disagree with this result for various reasons: First, it is argued that the methodology used for defining the relevant product market was an undue import of antitrust market definition, which has distinct

[87] ABR, *Canada-Renewable Energy,* paras. 5.174-5.175.
[88] *Ibid.*, para. 5.175.
[89] Charnovitz, S., & Fischer, C. (2015), p. 195.
[90] *Ibid*.

purposes as compared with subsidy control[91]; for instance, although there is a rationale for considering supply-side factors in an antitrust analysis, it makes no sense to do so for a benefit analysis within the boundaries of subsidy control[92]. Second, it is also criticized that the AB used the ruling of the case *EC-Large Civil Aircraft* to justify the consideration of supply-side factors in the definition of the relevant market. Cosbey & Mavroidis and Pal explain that the use of supply-side factors for the purpose of defining a relevant product market in that case obeyed to a different context –the determination of injury-, therefore it cannot be transposed to a benefit analysis since the analysis of injury –as in the *EC-Large Civil Aircraft* Case- has distinct particularities[93].

Finally, it has also been considered that the "narrow" definition of the relevant market was specifically tailored to that policy measure[94], and that the AB, by equating politician preferences with consumer preferences and introducing policy considerations into the determination of benefit, has created a "slippery slope"[95].

4.3.2 Governmental Intervention on Electricity Markets

Previously, the Panel Report had acknowledged the fact that "*competitive wholesale electricity markets* [would] *only rarely operate in a way that remunerates the mix of generators needed to secure a reliable electricity system with enough revenue to cover their all-in costs, let alone a system that pursues human health and environmental objectives through the inclusion of facilities using solar PV and wind technologies into the supply-mix*"[96], and noted that "*this goal can only be achieved by means of governmental intervention in what would otherwise be unacceptable*

[91] Rubini, Luca (2015), pp. 218-219.
[92] Cosbey, A. & Mavroidis, P. C. (2014), p. 11.
[93] *Ibid*; Pal, Rajib (2014), pp. 129-130.
[94] Rubini, Luca (2015), pp. 218-219.
[95] Charnovitz, S., & Fischer, C. (2015), p. 104.
[96] PR, *Canada-Renewable Energy,* para. 7.309.

competitive market outcomes"[97]. Hence, what the Panel meant was that, although understandable, there is a necessary governmental intervention on electricity markets to assure a sustainable electricity system, but which distorts the market and prevents it from serving as an appropriate benchmark.

However, the AB strongly opposed to this logic. It argued that a market-based approach to benefit benchmarks does not exclude taking into account situations where governments intervene to create markets that would otherwise not exist. Although it recognized that this type of intervention has an effect on prices, which means that in this situation prices would not reflect perfectly the unconstrained forces of supply and demand, it stated that it does not exclude *per se* the resulting prices as market prices for the purpose of a benefit analysis under article 1.1(b) of the SCM Agreement[98].

Moreover, the AB distinguished between different government interventions in a very controversial paragraph that reads:

"5.188. Nevertheless, a distinction should be drawn between, on the one hand, government interventions that create markets that would otherwise not exist and, on the other hand, other types of government interventions in support of certain players in markets that already exist, or to correct market distortions therein. Where a government creates a market, it cannot be said that the government intervention distorts the market, as there would not be a market if the government had not created it. While the creation of markets by a government does not in and of itself give rise to subsidies within the meaning of the SCM Agreement, government interventions in existing

[97] *Ibid.*, para. 7.312.
[98] ABR, *Canada- Renewable Energy,* para. 5.185.

markets may amount to subsidies when they take the form of a financial contribution, or income or price support, and confer a benefit to specific enterprises or industries"[99].

In the light of the above, the AB concluded that the benefit benchmarks for wind and solar PV-generated electricity should be found in the markets for wind and solar PV-generated electricity that are created through the supply-mix definition. The latter conclusion was not only based on its novel definition of the relevant market; it was also based on the understanding that these markets are not distorted by governmental intervention as long as this intervention seeks to create these markets.

Thus, to determine the benefit, the AB explained that the benchmarks for the comparative analysis should be the terms and conditions that would arise from market-based conditions for each of these sources of electricity, "*taking the government-determined supply mix as given*"[100]. Rubini goes further to extract from this conclusion that when there is a new market, and the creative act is simply directed to bring this market into existence, "*WTO subsidy laws do not apply*", and suggests that this was a way in which the AB sought to exclude certain forms of subsidization from WTO subsidy control[101].

According to Chamovitz & Fischer, this new position of the AB is a "*turn toward dirigisme*". They argue that the reasoning turned from the market as a key point of reference, to an emphasis on government volitions. In this sense, by discussing the *Canada-Renewable Energy* Report, they state that:

"*The Appellate Body first shields government dictates on technology from being considered a subsidy, and then subordinates real world market outcomes to the markets that a government*

[99] *Ibid.*, para. 5.188.
[100] Charnovitz, S., & Fischer, C. (2015), p. 196.
[101] Rubini, Luca (2015), p. 212.

would prefer to exist, when the government is, in effect, putting money (or the taxpayers' money) where its mouth is by using government procurement to reshape demand"[102].

Beyond the implications of this new concept of "creation of a market", the reasoning that led the AB to that conclusion has also been criticized. The main critics of this ruling argue that there is no legal or economic underpinning to differentiate between creative or distortive governmental interventions and that it seems as an unfit inclusion of mere policy arguments in the decision[103]. Also, it has been criticized that the boundaries between market creation and market distortion remain unclear, and that the AB did not provide further guidance to distinguish between one another[104]. Moreover, Rajib Pal considers that the analysis of the AB is flawed, and opened the door to subsidize inefficient technologies. He maintains that the measure of the case did not actually seek to bring a new product to a new market, but rather was a governmental intervention to support higher-costs producers in an existing market, which was achieved by creating an artificial construct that does not respond to reality[105].

4.3.3 Implications of the ruling

The general conclusion to which commentators of this ruling arrive is that it created a carve-out of certain types of action from subsidy laws[106], opening the door for WTO members to "pick and choose" technologies that they wish to promote in their markets without implications under the subsidies disciplines, and removing certain trade-distortive government support programs from the scope of the SCM Agreement.[107]

[102] Charnovitz, S., & Fischer, C. (2015), p. 203.
[103] Rubini, Luca (2015), p. 221; Cosbey, A. & Mavroidis, P. C. (2014), p. 12-13.
[104] *Ibid.*
[105] Pal, Rajib (2014), p. 134.
[106] Rubini, Luca (2015), p. 221.
[107] Pal, Rajib (2014), p. 135.

As a conclusion to this chapter, a reference to the opinion of Andrew Lang, the Case Author of the 14th edition of the ELSA Moot Court Competition on WTO Law, deems more than appropriate: "*The point is crystal clear: what is happening in these and other examples is not the objective definition of a subsidy by reference to an idealized natural market; instead, there is the contingent claim that a certain kind of measure should (or should not) be treated as if it were a subsidy for present purposes, based on a particular understanding of the objectives of the Subsidies Agreement, and the institutional role of WTO dispute settlement. The notion of subsidy, in other words, is only ever defined for a specific purpose and relative to a particular context*"[108].

4.4 Relation between the ruling and the 14th edition Case

Just like the analyzed ruling, the fictitious case *Eriador-Measures Affecting the Electricity Sector* has to do with an alleged subsidization to renewable energy technologies made by Eriador (Respondent), which is challenged by Borduria (Complainant). The challenged measures are a bank loan (Eribank Loan), a grant (IFFG), and a Long Term Purchase Agreement of electricity (LTPA). All the fictitious claims were made under the SCM Agreement, specifically articles 3.1(a), 6.3(a) and 6.3(c); however, the most relevant claim for the purpose of this paper is the challenge to the LTPA, as it resembles very much the FIT Scheme that was challenged in the analysed ruling. This claim fostered the discussion about the definition of the relevant market in energy markets, and of qualification of a market intervention that creates a market, which were reopened by the participants. Without prejudice to the other claims, which also deal with the SCM Agreement, we encourage the reader to focus mainly on the LTPA claim.

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[108] Lang, Andrew T. F. (2014), p. 21.

Finalizing this thorough introduction, we provide in the next pages the fictitious case, on which the 14th edition of the ELSA Moot Court was based, as well as our written submission for the respondent.

4.5 Conclusion to Section I

Subsidies as a discipline in international trade create, by its own nature, political tension amongst WTO members. Long before the SCM Agreement was enacted following the Uruguay Rounds, countries were aware that subsidies were highly effective policy instruments which were difficult to be regulated. The issue is not whether subsidies are bad *per se* but rather how they are applied in highly-intricate and complex market economies. As analyzed, subsidies can be defended economically but from a perspective of political economy they are usually in a reckless and irresponsible way, creating more harm than achieving its purported goals.

The case of *Canada- Renewable Energy* provides a particular and distinctive complication to the economical debate. In international trade, the decision is criticized because of its pretended erratic econometric analysis but also because a sort of judicial activism was appreciated. The Appellate Body mingled, in between lines policy arguments and filled the law with this content the provisions of the SCM. The decision though provides useful insight and revolutionary ideas such as the discussion of benchmarks. This decision marks a precedent and leaves the question open – problematically- of how to structure subsidies in a way that manages to solve global problems but without unduly restricting trade.

II. SECTION II- THE CASE

ELSA Moot Court Competition (EMC2) on WTO Law[109]

Case 2015-2016

Eriador – Measures affecting the electricity sector

by Andrew Lang

Foreword[110]: The case that is transcribed below was the official case that the authors of this thesis defend before a panel of experts in the siege of the WTO in Geneva, Switzerland. The authors were part of the team that was awarded with the wining team in the ELSA global competition. The case presented below presents a general tension: the right of Borduria to trade in an unrestricted and fair manner, with the national right of Eriador to develop projects that are desirable environmentally and economically. The case is designed to be defended and solved before a WTO panel, and hence it is purported to be defended litigiously. Both parts have strong arguments in the sense that the collision between the rights therein is not easily reconcilable and difficult to ponder. The case consists of three attacked measures by the complainant which altogether are designed by Eriador or private companies in that country to develop cold fusion energy by means of an engineering discovery: the Fusilliscope. Borduria has seen a profound decrease of its traditional energy sources exports and thus requests the panel to declare the measures inconsistent with the SCM Agreement.

Professor of Law in the Law Department of the London School of Economics

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[109] The case can also be retrieved from the ELSA Moot Court on WTO Law webpage following this link: http://files.elsa.org/MCC/EMC2/EMC2_15-16_case.pdf (last visited: 24 October 2016).

[110] This appreciation is not part of the original case of the ELSA 14th edition. It is included as a brief introduction to the interest of the reader.

1. Eriador is a major industrialised country, and a Member of the WTO, which is actively seeking to limit its dependence on fossil fuels, and to move its economy towards full reliance on sustainable and renewable energy sources. It is a party to the Framework Convention on the Promotion of Renewable Energy 2010 ('FCPRE'), a large multilateral treaty with 173 states parties. 145 countries are both WTO Members and states parties to the FCPRE. The Preamble to the FCPRE reads:

Recognising that existing global energy markets are distorted, due to the failure of such markets to internalise the full cost of carbon,

while Article 11 requires each states party to 'use all available means to encourage the rapid development of renewable energy, with a view to ensuring that at least half of its population's energy needs are met by renewable energy suppliers by 2020'.

2. Electricity generation facilities in Eriador are all privately owned, and include plants representing a wide range of generation technologies (coal, natural gas, nuclear, solar, wind, tidal, hydro). These electricity generators, as well as some foreign suppliers, sell their energy to the Eriadorian Electricity Corporation (EEC), a government agency whose function is to administer the day-to-day functioning of the grid in the interests of stability and efficiency. The EEC then sells the energy directly to consumers. The EEC is under an obligation to ensure that a specified (and gradually increasing) proportion of the electricity it purchases is generated from renewable sources. In 2015, the mandated proportion was 30%, and the actually achieved proportion was 31%.

3. Prices at the wholesale level are set by a combination of long-term contracts of 20 to 30 years duration (accounting for one third of supply), medium-term contracts of 5 to 15 years duration (accounting for another third), and spot market transactions for the remainder.

Contracts are awarded through open competitive tendering processes. Prices in spot markets are set via the auction method.

4. CleanTech is a large technology company based in Eriador, which specialises in the development and commercialisation of cutting edge, innovative technologies for the renewable energy sector.

5. For many years, CleanTech has been conducting research into cold fusion, a means of producing energy through nuclear reaction at, or close to, room temperature, without the toxic by-products associated with current nuclear (fission) technology. This research has been very successful. In just over a decade, CleanTech managed to develop cold fusion technology close to the point of commercialisation, most significantly through the invention of the Fusilliscope, a revolutionary device which enables users temporarily to overcome repulsive forces between atomic particles, at comparatively low energy cost.

6. In 2008, CleanTech established a production facility for the Fusilliscope. Initially, it sought funds for this project from private investors, but was unsuccessful due to the project's extremely high risk profile, the unproven nature of the technology, uncertainty concerning the anticipated costs of electricity generation using the technology, and the huge capital investment needed. Instead, it obtained a $750m loan on favourable terms from Eribank, an entity majority owned by the Eridorian state. Eribank is governed by a board of directors appointed by the Eriadorian Ministry of Commerce, but with each appointee acting in his or her independent capacity. It is run largely on a commercial basis, but by its constitution is required to conduct its business 'having regard to the strategic policy priorities of the Eriadorian state' and 'in consultation, as appropriate, with relevant government ministries'. In the case of the loan to CleanTech, Eribank consulted with the Eriadorian Ministry of the Environment as to their view of the commercial viability of this new

technology, as well as its significance for Eriadorian economy generally. The Ministry of the Environment expressly supported the loan, while acknowledging that the final decision whether or not to grant it was for Eribank itself. Eribank is also, separately, used on occasion as the vehicle through which the Eriadorian government disburses funds to Eriadorian businesses under government grant programs.

7. Over the next 12 months, CleanTech perfected its production process, made minor amendments to the design of the Fusilliscope, and developed relationships with potential users of the technology, as it prepared this division of its business for sale. Then, in early 2009, CleanTech sold the entire Fusilliscope business – including the production facility, as well as all intellectual property rights to the technology – to Future Energy, a company incorporated in Eriador whose core business is the construction and operation of power plants in Eriador. Future Energy is unrelated to CleanTech, and the purchase of the Fusilliscope business was at a price which reflected its full market value, as certified by an independent auditor.

8. Future Energy quickly integrated the Fusilliscope into its domestic power generation facilities, and also began selling the Fusilliscope to electricity suppliers operating in foreign markets. To safeguard its position as market leader in the commercialisation of cold fusion technology in Eriador, it did not sell or license the Fusilliscope to other generators of electricity operating in Eriador.

9. However, it soon became clear that the costs of producing electricity using the Fusilliscope were considerably higher than the wholesale price of electricity in the Eriadorian electricity market. It consequently turned to the Eriadorian government for assistance.

10. Convinced of the long term viability of this technology, and of the potential significance of exports of Fusilliscopes for the Eriadorian economy, Future Energy was awarded a $500m grant

under the Eriadorian government's 'Innovation for the Future' program. Open to any business operating in any sector of the Eriadorian economy, this program seeks to provide financial assistance to projects which promise to make a significant contribution to the sustainable growth and global integration of the Eriadorian economy. Over the three years it has been running, 90% of funds disbursed under this scheme have gone to companies operating in the renewable energy sector.

11. In addition, at the same time, the Eriadorian government implemented a new feed-in-tariff scheme to increase the supply of electricity from cold fusion, pursuant to a Direction from the Ministry of Commerce in the exercise of its statutory authority. Participants in the scheme are awarded contracts with the EEC, containing the same standard terms, and of the same duration, as long term purchase agreements between the EEC and other providers of both renewable and non-renewable energy. The only salient difference is the price offered. Under this scheme, Future Energy was awarded a long term purchase agreement with EEC, under which EEC would pay a guaranteed price to Future Energy, for all electricity produced from its cold fusion plants, for a period of 30 years. The guaranteed price under the contract was set according to the following formula:

$$C = M + X*Y$$

where C is the daily contract price, M is the average unit wholesale electricity price in Eriador for that day, X is the average number of tons of carbon emitted in the production of one unit of electricity placed on the wholesale market, and Y is the true social cost of one ton of carbon, initially set at $152/ton by an independent agency on the basis of peer-reviewed papers and international practice, but periodically reviewed. The formula was designed to ensure that the price paid to Future Energy closely approximates the 'true' cost of electricity – namely, what the

wholesale cost of electricity would be, if the full social costs of carbon were fully internalised. The Direction of the Ministry of Commerce establishing the scheme notes that it has been adopted in accordance with Eriador's obligations under Article 11 of the FCPRE.

12. In the five years since these measures were put in place, Future Energy has significantly increased its market share in Eriador's wholesale electricity market, from 2% in 2010 to 36% in 2015. It has built several more generation facilities using cold fusion technology, and sells all its energy from them into the grid under the terms of the long term contractual agreement outlined above. In addition, it has spent $500m constructing and commissioning an additional production facility for Fusilliscopes, which has allowed it massively to expand its export sales of Fusilliscopes. It now exports this technology under licence to electricity producers in over 50 countries worldwide. It does not sell any Fusilliscopes domestically, in part because that may increase the number of suppliers competing for contracts under the government's feed-in-tariff scheme.

13. Borduria is an industrialised country, and Member of the WTO, which shares a border with Eriador. Like Eriador, it is a party to the FCPRE. The electrical grids of the two countries are interconnected, such that Bordurian electricity generators are able to transmit their electricity into the Eriadorian grid, and sell into the Eriadorian market. Borduria's two primary electricity producers, and its only electricity exporters – both of whom still operate traditional coal-fired power stations – have complained that their share of the wholesale electricity market in Eriador has declined precipitously since 2010, from 50% to just 23% in 2015, just as Future Energy's market share has risen, in accordance with the following table.

Company	**Nationality**	**Market Share**
Future Energy	Eriador	2010: 2%

		2011: 3% 2012: 15% 2013: 22% 2014: 29% 2015: 36%
Borduria Energy Corporation	Borduria	2010: 20% 2011: 20% 2012: 16% 2013: 14% 2014: 12% 2015: 11%
Electricity Borduria	Borduria	2010: 30% 2011: 30% 2012: 26% 2013: 21% 2014: 17% 2015: 12%
Other	Eriador	2010: 46% 2011: 45% 2012: 41% 2013: 41% 2014: 41% 2015: 40%

Other	Other	2010: 2% 2011: 2% 2012: 2% 2013: 2% 2014: 1% 2015: 1%

No company other than Future Energy has gained market share in that period, and the size of the overall market has stayed essentially stable over the period. The Bordurian suppliers complain also that their contractual arrangements with the Eriadorian government for the wholesale supply of electricity into the Eriadorian grid have not been renewed, with five major contracts expiring in 2012, 2013 and 2014 (two for the Bordurian Energy Corporation, and three for Electricity Borduria). They note that in its Annual Reports of Operations, the EEC has reported that this was the direct result of the unexpectedly large size and costs of the long-term contracts put in place with Future Energy.

14. Borduria is also home to SolarTech, a world leading company specialising in the production and export of solar panels. In late 2012, it signed a Memorandum of Understanding with Elektrica, an electricity generation company based in the state of Carpathia, for the supply of 40,000 solar panel units on terms to be agreed. In 2013, Elektrica broke off negotiations in their final stages, informing SolarTech that they had been approached by Future Energy with an offer for the sale of Fusilliscopes at 50% of the price at which they would normally be sold, and as a result had decided on the basis of cost to refocus their investments away from the creation of new solar energy facilities, towards cold fusion.

Legal Claims

15. Borduria requests consultations with the government of Eriador, in respect of: (a) the loan by Eribank to CleanTech; (b) the FIT scheme, and the contract between EEC and Future Energy concluded pursuant to it; (c) the 'Innovation for the Future' grant to Future Energy.

The Request was accompanied by a Statement of Available Evidence in the form required by Articles 4.2 and 7.2 of the *SCM Agreement*. During the course of these consultations, both parties agreed to proceed on the basis that electricity is a product, not a service. Eriador also made clear that, it does not contest that the Eribank loan would confer a benefit within the meaning of Article 1.1(b) if it were established that the loan was granted by a public body. The parties could not resolve their disagreement concerning the legal relevance to this dispute of the FCPRE.

16. Borduria considers that these measures constitute specific subsidies within the meaning of Article 1 of the *SCM Agreement*, and claims that they are inconsistent with Eriador's obligations under that agreement as follows:

a. That the 'Innovation for the Future' grant is inconsistent with Article 3.1(a) of the *SCM Agreement* because it is contingent in fact upon the export by Future Energy of equipment for renewable energy generation;

b. That the loan by Eribank and the 'Innovation for the Future' grant cause serious prejudice to the interests of Borduria within the meaning of Article 5(c) of the SCM Agreement and Article XVI:1 of the GATT 1994, as they have resulted in lost sales of solar panels in the market for energy generation equipment in Carpathia within the meaning of Article 6.3(c) of the *SCM Agreement*;

c. That the long term purchase agreement between Future Energy and EEC, concluded pursuant to the FIT Scheme, causes serious prejudice to the interests of Borduria within the meaning of Article 5(c) of the SCM Agreement and Article XVI:1 of the GATT 1994,

as it has displaced and impeded imports of electricity from Borduria into Eriador within the meaning of Article 6.3(a) of the *SCM Agreement*.

III. SECTION III- CASE RESOLUTION

Team: [046]

ELSA MOOT COURT COMPETITION ON WTO LAW

2016

Eriador-Measures Affecting the Electricity Sector

Borduria

(Complainant)

v.

Eriador
(Respondent)

SUBMISSION OF THE RESPONDENT

Statement of Facts

- Borduria and Eriador are industrialised countries. They are both WTO members and parties to the VCLT and the FCPRE -which recognises that energy markets are distorted and imposes the obligation to parties to ensure that at least half of its population energy needs are met by RE supplier by 2020-.
- All EG facilities in Eriador are privately owned and produce their output using a wide-array of technologies. These EGs sell their energy to the EEC at the wholesale level and then the latter distributes it to consumers at the retail level. EEC must ensure that a fixed proportion of this electricity comes from RE. Prices at the wholesale level are fixed by a combination of LTC, MTC and SMT in competitive processes.
- CT is an Eriador-based company that specializes in technology development in the RE sector. In 2008 CT established a production facility for the FS, a device that enables the production of CFE. Such FSPF was commissioned by means of a $750m EL.
- Eribank is a SOCB. It directs its business on a commercial basis and its board of directors act in their own independent capacity. The EL was granted as a final decision of the board of directors of the entity.
- In 2009, CT sold the entire FS business to FE, a company incorporated in Eriador whose core business is the construction and operation of power plants. The business was sold at fair market value. FE did not sell or license the FS to other EGs operating in Eriador.
- The costs of producing electricity using the FS are considerably higher than the WEP.
- In 2010 FE was awarded a $500m grant under the IFFP. The program seeks to provide companies with financial assistance if they comply with the objectives set by the GOE. Simultaneously, in accordance with the obligation of Eriador under the FCPRE, the FITS was

implemented. Pursuant to the FITS, CFE EGs were awarded LTC with the EEC. These LTC were made based on a price-formula that added to the WEP a factor which recognised the cost of carbon emission in producing one unit of electricity.

- Borduria complained that BEC and EB have lost significant market share in the EEM. This, according to Borduria, is due to the high costs of the LTC pursuant to comply with the FITS.
- In 2013, Elektrica broke off negotiations with ST for the supply of 40,000 solar panel units. As a result, FE managed to make a deal with Elektrica by selling the FFSS.

Summary of Arguments

1. The IFFG is consistent with Art. 3.1(a) of the SCM

- IFFG is a measure which is not contingent in fact upon export performance, since:

o The GOE did not anticipate exports or export earnings from sales of REGE arising from the granting of the IFFG given that the implementation of the FITS ensured that the extra FFSS produced by the second FSPF were to be destined for the production of CFE EG.

o The IFFG was not "*tied to*" actual or anticipated exportation or export earnings, as it was not geared to induce the promotion of future export performance of FFSS. The IFFG did not provide an incentive to export in a way that is not simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy. In other words, the IFFG did not alter the circumstances available in the market of REGE and was therefore not geared to induce more exports. Additionally, the relevant circumstances surrounding the awarding of the IFFG evidence that the GOE regarded as a primary policy the encouragement of RE production. Thus, it would have been contradictory that the GOE promoted exportations when the primary objective was to shift towards RE EG.

2. The EL and the IFFG are consistent with Arts. 5(c) and 6.3(c) of the SCM

- The IFFG is not a specific subsidy within the meaning of Art. 2 of the SCM and hence it is not subject to the provisions of Part III of the SCM. This since the IFFP did not explicitly limit the access to certain enterprises and, on the contrary, is broadly available throughout the economy.
- The EL is not a subsidy- SCM Art. 1.1- as a "*public body*" did not grant it, given that:
  - Eribank is not vested with and does not possess *governmental authority* since the entity conducted its business on a commercial basis and the industry of lending money is not regarded as a *governmental function* within Eriador. Additionally, the fact that the entity had to regard the strategic policies of Eriador when conducting its business it's different to carry out a *governmental function* since the obligation informs the conduction of business but does not constitute in itself the exercise of that kind of functions.
  - The GOE did not entrust or direct Eribank with the responsibility of carrying out one of the functions provided in Art. 1.1(a)(1)(i-iii) of the SCM, since the board of directors acted in their own capacity and independence when granting the EL. Additionally, the AB has stated that meres act of guidance or encouragement does not amount to entrustment or direction and, thus there is no evidence to conclude that a financial contribution was granted indirectly by the GOE.
- The IFFG and the EL did not cause adverse effects to the interests of Borduria within the meaning of Arts. 5(c) and 6.3(c) of the SCM, as:
  - The IFFG and the EL where not the *genuine* and *substantial* cause of the lost sale of solar panel equipment in Carpathia, since the lost sale would have occurred anyhow "*but for*" the measures. The *"benefit*" that was granted to CT by Eribank was extinguished when FE bought the FS division and fair market value. This amounts to conclude that the EL was not the cause of the lost sale of solar panel equipment. Also, the IFFG did not result in the lost sale since FE regarded

the Carpathian REGE as of "*strategic importance*" and, thus even "*but for*" the measure, FE would have still conducted a temporary aggressive price campaign.

3. The LTPA is consistent with Arts. 5(c) and 6.3(a) of the SCM

- The LTPA is not a "*subsidy*"- SCM art. 1.1- as a "*benefit*" is not conferred to FE as:

o The relevant market for the "*benefit*" analysis is the CFE market since this type of electricity is not substitutable –both from the demand and supply side- at the wholesale level with other RE EGs and, thus, it is unable to impose competitive constraints to the latter.

o The suitable benchmark for performing a "*benefit*" analysis is the price included in the LTPA as it reflects the "*prevailing market conditions"* within the meaning of Art. 14(d) of the SCM as interpreted by the FCPRE. Hence, the purchase of goods concluded by the EEC does not provide "*more than adequate remuneration"* as the price is only *adequate"*.

- The LTPA does not result in serious prejudice in the terms of Art. 5(c) of the SCM as it has not resulted in displacement and impedance of electricity generated in Borduria and coming into Eriador, because:

o There are non-attribution factors –namely climate change and international commitments around this issue- that dilutes the causal link between the LTPA and the phenomenon in Art. 6.3(a) of the SCM. Accordingly, displacement and impedance would have occurred "*but for*" the LTPA.

- The LTPA is covered by the exception provided in Art. XX (d) of the GATT, since:

o Art. XX of the GATT is available to justify a measure found to be inconsistent with obligations under the SCM since there are interpretative elements that indicate so.

o The LTPA is a measure that falls into the exception XX (d) of the GATT because it is "*necessary to secure compliance*" with the obligation provided in Art. 11 of the FCPRE and when *applied* it complies with the *chapeau* as it does not result in "*arbitrary or unjustifiable*

discrimination".

Identification of WTO Measures at Issue

Measure 1: The IFFG, a $500m grant under the GOE IFFP that seeks to provide financial assistance to projects which promise to make a significant contribution to the sustainable growth and global integration of the Eriadorian economy.

Measure 2: The EL, a $750m loan disbursed by Eribank to CT.

Measure 3: The LTPA concluded between FE and the EEC under the FITS, which sought to increase the supply of electricity from CFE. It provided a guaranteed price under the formula C=M+X*Y.

Legal Pleadings

5. The IFFG complies with Art. 3.1(a) of the SCM

1. The IFFG is WTO-consistent as it is a measure not contingent in fact upon export performance or export earnings of REGE. Art. 3.1(a) of the SCM prohibits *"subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance",* whilst footnote 4 of such provision sets the standard for determining *de facto* export contingency[111]. The AB has stated that the fulfilment of that standard requires evidence of three elements: i) the "*granting of a subsidy*"; ii) is "*tied to*"; iii) "*actual or anticipated exportation or export earnings*"[112]. The last two elements are not met.

[111] ABR, *EC- Large Civil Aircraft,* para. 1036; ABR, *Canada- Aircraft,* para. 108.
[112] ABR, *Canada- Aircraft*, para. 169.

5.1 The GOE did not anticipate exportation or export earnings

2. The IFFG is not contingent in fact upon export performance since the GOE did not anticipate export earnings arising from the measure. The AB has indicated that in order to determine whether exportations were anticipated, the relevant enquiry is *"whether the granting authority expected exports to ensue or arise out of the granting of the subsidy*"[113]. Also, *"whether exports were anticipated or 'expected' is to be gleaned from an examination of objective evidence.*

3. The GOE did not anticipate this result since it cannot be concluded that the GOE expected an increase of FS exports, due to the higher demand of FFSS in Eriador that would arise pursuant to the FITS implementation[114]. The FITS was enforced "*at the same time"*[115] the IFFG was awarded, with the objective to increase the supply of CFE in the market[116]; certainly the increase in the demand of CFE meant an increase in the demand of FFSS in Eriador- as the FS is a necessary device for the production of this kind of electricity[117]-. Hence, although the second FSPF permitted an increase in the production of FFSS, the demand for this device in Eriador was also expected to rise, which means that it was not to be expected that the exports of FFSS would increase.

4. In sum, since the GOE did not expect exports to arise out of the granting of the subsidy, the IFFG shall not be found to be a measure contingent in fact upon export performance.

5.2 The IFFG was not "tied to" actual or anticipated exportation or export earnings

5. Regarding the second element mentioned in section 1, the IFFG was not contingent in fact upon export performance since it was not "*tied to*" actual or "*anticipated exportation or export earnings*", as it was not geared to induce the promotion of future export performance of FS. Even

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[113] ABR, *US- Aircraft,* para. 7.1533.
[114] Case fact number 9-10.
[115] Case fact number 11.
[116] *Ibid*., 11.
[117] Case fact number 5.

if anticipated exportation was to be gleaned from an examination of objective evidence, the AB has emphasized that this fact alone is not sufficient to demonstrate that a subsidy is export contingent[118]: Accordingly, it stated that: "*the legal standard for de facto export contingency under Art. 3.1(a) and footnote 4 of the SCM requires that there exists a relationship of conditionality between the granting of the subsidy and anticipated exportation*"[119]. In order to evidence such conditionality relationship, the AB established the following test: "*Is the granting of the subsidy geared to induce the promotion of future export performance by the recipient*?[120]" Moreover, the AB has considered that a subsidy *shall* comply with this test when it is granted to provide an incentive to the recipient to export in a way that is not *"simply reflective of the conditions of supply and demand in the domestic and export markets undistorted by the granting of the subsidy"*[121].

6. Before and after the granting of the IFFG, FE had a monopoly over the generation and supply of CFE in Eriador as it was the only EG that had access to FFSS[122]- a necessary input for the generation of that kind of energy[123]-. Accordingly, it did not sell or license FFSS to other EGs operating in Eriador precisely to safeguard its position as market leader in the commercialization of CFE[124]. This meant that the remainder of the production of FFSS that were not reserved for its own use, if any, would be exported. The aforementioned was reinforced with the implementation of the FITS, since only CFE EGs could participate in the program[125]. As a consequence, whether the subsidy was granted or not, FE would export all the remainder of FFSS, a result that is reflective of the conditions of the market, and not a result of an incentive provided by a subsidy. As the AB

[118] ABR, *Canada- Aircraft,* para. 172.
[119] ABR, *EC- Large Civil Aircraft,* para. 1044.
[120] *Ibid.,* para. 1044. (Emphasis Added)
[121] ABR, *EC- Large Civil Aircraft,* para. 1045.
[122] Case fact number 7.
[123] Case fact number 5.
[124] Case fact number 8 and Clarification question number 1.
[125] Case fact number 11.

stated, even if an increase in the production subsequent to a granting of a measure is exported in whole, the standard is not met when it is the result of market conditions[126]. On the other hand, the IFFG did not provide either an incentive to skew the stock of FFSS reserved by FE specifically for its own use, towards export sales. This conclusion arises from the examination of the "*modalities of operation"* of the IFFP, and the "*relevant circumstances surrounding the granting of the subsidy"*, which may be considered to determine *de facto* export contingency[127].

7. Vis-à-vis the *relevant circumstances*, the IFFG was awarded after the FCPRE came into force[128]. This instrument states that Eriador is under the obligation to "*use all available means to encourage the rapid development of RE*"[129]. Pursuant to this obligation, Eriador -together with the IFFG- implemented the FITS with the objective to increase the supply of CFE[130]. As to the *modalities of operation*, over the five years the IFFP has been in operation, 90% of the funds disbursed have gone to companies operating in the RE sector. Thus, it is clear that the encouragement of the rapid development of RE is a primary policy of the GOE. *Ipso facto,* to conclude that the IFFG sought to skew reserves of FFSS for its own electricity generation towards export sales would be contradictory, since it would mean that Eriador was encouraging an enterprise to reduce its generation of RE in order to increase its exportations or export earnings, obstructing the compliance of Art.11 the FCPRE. Hence, the IFFG was not "*tied to actual or anticipated exportation or export earnings*" as: i) it could not promote an export performance that would exist anyway as a reflection of the market conditions, and ii) did not provide an incentive to skew the stock of FFSS by FE for its own use towards export sales.

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[126] ABR, *EC- Large Civil Aircraft,* para. 1045.
[127] *Ibid*., para. 1046 .
[128] Clarification question number 31.
[129] Case fact number 1.
[130] Case fact number 11.

8. In sum, the IFFG is not a measure contingent upon export performance since the GOE did not anticipate that FS exports would arise and, additionally, the granting of the measure was not "*tied to*" export performance.

6. The EL and the IFFG are consistent with Arts. 5(c) and 6.3(c) of the SCM

6.1 The IFFG is not a specific subsidy

9. The IFFG cannot be challenged under the provisions of part III of the SCM, as it is not a "*specific subsidy*" within the meaning of Art. 2. SCM. Art. 1.2 provides that "a *subsidy* (...) *shall be subject to the provisions of part III (...) only if such a subsidy is specific in accordance with the provisions of Article 2".* Moreover, a subsidy will be specific if the legislation pursuant to which the granting authority operates explicitly limits access to a subsidy to certain enterprises[131].

10. The IFFG is not *de jure* specific because the legislation pursuant to which the granting authority operates does not explicitly limits access for certain enterprises to the program as it is open to any business operating in any sector of the Eriadorian economy[132]. Therefore, the IFFG cannot be challenged under part III of the SCM, as it is not a specific subsidy, since it is not specific.

6.2 The EL is not a subsidy, as a "public body" does not grant it.

11. The EL does not fall under the scope of the SCM because it is not a subsidy, as a "*public body*" within the meaning of Art 1.1 of the SCM did not grant it. A measure is a "*subsidy*" within the meaning of Art. 1.1. of the SCM when it is or provides: i) a "*financial contribution*", ii) it is granted by a government or a *"public body"* and iii) results in a "*benefit*" for the recipient[133]. According

[131] Art. 2.1(a) SCM (Emphasis added).
[132] Case fact number 10 and Clarification question number 22; ABR, *US- Antidumping and Countervailing Duties (China),* paras. 366-371.
[133] Art. 1.1(b) of the SCM; ABR, *EC-Large Civil Aircraft,* para. 873.

to the AB, a "*public body*" is an "*entity that possesses, exercises or is vested with **governmental authority**"*[134].

12. Albeit it has been clarified that having the power to "*regulate*" is not essential in order to be a "*public body*"[135], the AB has not yet defined what it means to be "*possessing, exercising or vested with governmental authority*". The ordinary meaning of the word 'authority' that accompanies the word 'government' denotes "***the power or right to give orders, make decisions and enforce obedience**"*[136]. Indeed, the word 'authority' designates a position of pre-eminence of the State with respect to the individuals. This possibility to enforce decisions should be the appropriate understanding of the characteristic set by the AB, according to which an entity is vested with "*government authority"* and is therefore a "*public body*".

13. There is no indication that Eribank was vested with or possessed such authority. As the AB emphasized, "*an entity's sustained and systematic practice of exercising governmental functions may serve as evidence that it possesses or has been vested by governmental authority*"[137]. The practice of Eribank makes patent that business was conducted on a commercial basis[138] and if it served as vehicle from which the GOE disbursed funds under different programs[139], this mere fact does not reveal the exercise of a public function but rather that of a regular bank. Moreover, the AB also established that a function might be regarded as 'governmental' if it is considered as such within the legal order of the relevant member[140]. The banking function is not considered as such within the legal order of Eriador since: i) The entire banking system in Eriador corresponds to a

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[134] ABR, US–*Antidumping and Countervailing Duties (China),* paras. 317-318; ABR, *US-Carbon Steel (India),* para. 4.17 (Emphasis added).
[135] ABR, *US-Carbon Steel (India),* para. 4.17.
[136] "Authority". OED (2015) www.oxforddictionaries.com/us/definition/american_english/authority. (27 December 2015) (Emphasis added)
[137] ABR, US–*Antidumping and Countervailing Duties (China),* para. 318.
[138] Case fact number 6.
[139] *Ibid., 6.*
[140] ABR, *US-Carbon Steel (India),* para. 4.29.

liberalised market, were many private banks operate[141], and ii) Eribank is not a central bank, on the contrary it is structured as a privately held company -*i.e*. not publicly listed[142].

14. Additionally, a distinction should be drawn, on the one hand, between the obligation to comply with the Eriadorian policies[143] and the exercise of governmental authority or functions, on the other. While the first one refers to the word 'policy', which designates "*a course or principle of action adopted or proposed by a government, party, business or individual*"[144], the word 'function' denotes "*an activity or purpose natural to or intended for a person or thing*"[145]. The fact that an entity is required to conduct its business regarding the Eriadorian policies does not purport the exercise of governmental functions; it merely signifies that a private entity such as Eribank, through its functions and private activities, should regard the policies designed by Eriador.

15. Finally, the GOE did not provide the "*financial contribution*" indirectly by entrusting or directing Eribank. According to Art. 1.1(a)(1)(iv) of the SCM, a *"financial contribution"* may also be provided indirectly[146] where a government "*entrusts or directs a private body to carry out one or more of the type of functions (...) illustrated in (i) to (iii)(...) which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments"*. The AB has interpreted that a finding of entrustment or direction requires that the government give responsibility to a private body—or exercise its authority over a private body—in order to effectuate a financial contribution[147]. Additionally, the AB prevented that entrustment or direction requires a more active role than "*mere policy pronouncements*" or "*mere acts of*

[141] Clarification question number 98.
[142] *Ibid.*
[143] Case fact number 6.
[144]"Policy". OED (2015). www.oxforddictionaries.com/us/definition/american_english/policy. (27 December 2015)
[145]"Function", (2015).www.oxforddictionaries.com/us/definition/american_english/function.(27 December 2015)
[146] ABR, *US-Countervailing Duty Investigations on DRAMs,* para. 108.
[147] *Ibid.,* para. 113.

encouragement"; and entrustment or direction cannot be a mere-by product of governmental regulation[148].

16. The support given by the Eriadorian Ministry of Environment was just a "*mere act of encouragement*" or "*mere policy pronouncement",* and cannot amount to find entrustment or direction, since the Ministry made clear that **the final decision whether or not to grant the loan was for Eribank itself**[149]. Additionally, the possible fact that Eribank decided to grant the EL to a RE company cannot be attributable to the GOE, but rather to a free choice by the actors in that market. As stated by the AB, there has to be a demonstrable link between the government and the conduct of the private body[150], which did not exist in this case.

17. Hence, the EL is not a "*subsidy*" within the meaning of Art. 1.1 of the SCM as Eribank is not a "*public body*", given that: i) it does not "*possesses or is vested with governmental authority*"[151], neither it exercises governmental functions and ii) the GOE did not provide indirectly a *"financial contribution"* by entrusting or directing Eribank to execute the EL.

6.3 The IFFG and EL did not cause adverse effects to the interest of Borduria within the meaning of Arts. 5 and 6 of the SCM

18. The IFFG and the EL did not cause adverse effects to the interests of Borduria as none of those measures caused the lost sale of solar panel equipment alleged by the complainant. Art. 5 of the SCM provides: "*no Member should cause, through the use of any subsidy* (...) *adverse effects to the interests of other Members, i.e.: (...) (c) serious prejudice to the interests of another Member.* Furthermore, Art. 6.3 states: "*serious prejudice in the sense of paragraph (c) of Art. 5 may arise*

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[148] *Ibid.,* para. 114.
[149] Case fact number 6. (emphasis added)
[150] ABR, *US-Countervailing Duty Investigations on DRAMs,* para. 112.
[151] ABR, *Antidumping and Countervailing Duties (China),* para. 318.

*in any case where (...) (c) the effect of the subsidy is a significant price undercutting (...) or **lost sales** in the same market"*[152].

6.3.1 The purchase of the FS division by FE to CT extinguished the "benefit" of the EL

19. The EL is consistent with arts. 5(c) and 6.3(c) of the SCM as it did not result in "*lost sales"* of solar panel equipment in the Carpathian market. Art. 6.3 of the SCM require the establishment of a causal link between the measures and the particular market situations being claimed[153]. The AB stated that "*a panel must assess whether there are "intervening events" –i.e.* the extinction of the benefit[154]- "*that occurred after the grant of the subsidy [and] may affect the projected value of the subsidy",* since such events *"may be relevant to an adverse effects analysis because they may **affect the link that a complaining party is seeking to establish between the subsidy and its alleged effects**"*[155]. Moreover, regarding the *extinction* of the benefit, the AB recognized that the "*benefit*" may be extinguished when an unrelated enterprise pays a fair market price for the assets that the predecessor company acquired with the financial contribution, since the *market value* is redeemed[156], and added that this conclusion is necessary when the transaction is between private parties that operate in competitive markets[157].

20. CT used the funds obtained with the EL to develop and prepare the FS division, but sold it afterwards to FE –an unrelated company- at a full market price[158]. This means that the possible benefit conferred to CT was extinguished as the *market value* of the purchased assets was redeemed. As a consequence, this *intervening event* eliminated any possible link between the

[152] Emphasis added.
[153] ABR, *EC-Large Civil Aircraft,* paras. 1231-1232.
[154] *Ibid.,* footnote 1644.
[155] ABR, *EC-Large Civil Aircraft,* para. 709. (Emphasis added)
[156] ABR, *US-Countervailing Measures on Certain EC Products,* para. 102.
[157] *Ibid*., para. 124.
[158] Case fact number 7.

subsidy and the alleged effects. Indeed, it was FE who began selling and distributing the FS. However, FE never enjoyed an advantage or was in a better off position as CT retained the benefit, materializing and eliminating the projected value of the subsidy.

21. Hence, a causal link between the subsidies and the alleged market phenomena cannot be established as it was extinguished by an intervening event –the extinction of the benefit-, since an unrelated company price purchased the FS division at fair market.

6.3.2 The IFFG was not the substantial cause for the "lost sales" of solar panels

22. The IFFG was not the "*genuine and substantial cause"* of the alleged market phenomena. A subsidy may cause adverse effects to the interests of another Member when it constitutes the *genuine* and *substantial* cause that produced the alleged result[159]. Moreover, the AB has concluded that in order "*to assess whether the particular market phenomena are the effect of the subsidies* (…) *one possible approach to the assessment of causation is an inquiry that seeks to identify what would have occurred "but for" the subsidies*"[160].

23. FE had an interest on entering the Carpathian market of REGE as it regarded this market as of "*strategic interest"*[161], and also believed that a large purchase of FFSS by Elektrica would persuade other potential clients that FFSS were a mature and reliable product; those were the reasons that justified a temporary aggressive pricing campaign[162], even if it represented a transitional loss in revenue, in view of the future benefits they would bring.

24. Furthermore FE felt able to offer the discount not only due to the economies of scale achieved with the second FSPF, but also due to the "*lessons learnt over the years*"[163] by the enterprise in

[159] ABR, *EC-Large Civil Aircraft*, para 1232.
[160] *Ibid.,* para 1233.
[161] Clarification question number 10.
[162] *Ibid.*
[163] Clarification question number 10.

the commercialisation of the device.

25. Hence, for the reasons aforementioned, FE would have anyhow conducted a temporary aggressive pricing campaign in view of the importance of achieving a large purchase of FFSS by Elektrica. *Ipso facto,* the lost sale would have occurred with or without the measure, excluding the IFFG as the *substantial* cause.

7. The LTPA is consistent with Arts. 5(c) and 6.3(a) of the SCM

7.1 The LTPA is not a "subsidy" within the meaning of Art. 1.1 of the SCM

26. The LTPA does not constitute a subsidy, as it does not confer a "*benefit*" to FE. Art. 1.1 provides that: "(...) *a subsidy shall be deemed to exist if:* (...) *a benefit is thereby conferred".* Accordingly the AB stated that a "*benefit*" *will* arise when the measure places the recipient in a more advantageous position than it would have otherwise been without it[164]. Furthermore when a "f*inancial contribution*" in the form of a "*purchase of goods*"[165] is granted, a "*benefit*" will only arise when the purchase of goods is made for "*more than adequate remuneration in the prevailing market conditions within the country of the purchase"*[166]. When undergoing the factual analysis under the preceding rule, it is nevertheless a prerequisite to define the relevant market -the AB has insisted-[167].

7.1.1 The relevant market for the "benefit" analysis of the measure is the CFE market

27. The relevant market where the measure at issue should be analyzed is the CFE market. The EC has stated that the relevant market is comprised of two components: i) the *relevant market of the*

[164] PR, *Canada- Aircraft,* para. 9.112.
[165] Art. 1.1(a)(1)(iii).
[166] Art. 14(d) of the SCM; ABR, *Canada- Renewable Energy,* para. 5.163; ABR, *EC- Large Civil Aircraft*, para. 703; ABR, *Canada- Aircraft,* para. 155.
[167] ABR, *Canada- Renewable Energy,* para. 5. 169.

product and, ii) the *geographical market*[168]-the Eriadorian grid were NRE coming from Borduria is transmitted-. The relevant market of the product comprises "*only those products that exercise competitive constraints on each other. This is the case when the relevant products are substitutable*"[169]. Accordingly, to determine whether two products are "*substitutable*" several factors may be considered, both in the demand –characteristics, uses and price[170]- and in the supply-side[171], mainly EGs cost structures[172].

28. Regarding demand-side factors, CFE has distinct characteristics that make the product non-substitutable to the wholesale consumer[173] –EEC-: i) CFE as a product is generated from air isotopes -Deuterium or ^{2}H is found in the air[174]- rendering the technology sustainable in the long-run without the problem of scarcity, ii) it contributes to mitigate and reverse the impact of climate change[175] since CO_2 emissions are absent, iii) CFE does not generate toxic by-products associated with fission technology[176], iv) contrary to other RE sources, CFE does not have low reliability[177] due to temporal variability and uncertainty caused by deviations between forecasted generation and actual production[178], v) CFE plants are non-location-specific since they do not require large tracts of land unlike solar panels and other RE EGs[179]. With respect to its uses, CFE can be used to supply flexibly normal and contingent variable needs that arise from retail consumers, since this

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[168] E.C (1997) para. 9.
[169] ABR, *EC-Large Civil Aircraft*, para 1120.
[170] E.C (1997) para. 9.
[171] ABR, *Canada- Renewable Energy,* paras. 5.167-5.169.
[172] *Ibid.,* para. 5.174.
[173] *Ibid.,* para. 5.176.
[174] UST (2016).
[175] IEA *(2015*, p. 17.
[176] Case fact number 5.
[177] Clarification question number 121.
[178] IRENA (2015), p. 10.
[179] Clarification question number 121.

type of electricity has the capacity to scale production up and down[180], transmitting base load, intermittent and peak-load output.

29. Supply-side factors also prove that CFE is non-substitutable with other EGs, since: the costs associated with CFE production are "*considerably higher*"[181] compared to those of NRE, which amounts to an impossibility of imposing competitive constraints to the latter type of electricity. Indeed i) CFE has high capital costs, even higher than those required to construct and operate a plant of solar technology[182], and ii) the levelised cost of producing one MWh of electricity is enormously different from RE compared to NRE sources –for instance, producing one MWh of solar electricity (comparable to CFE[183]) costs between 100 and 220 USD whilst the same MWh using coal costs between 60 and 70 USD[184]-.

30. In sum, CFE does not compete in the BEM since the former is neither demand nor supply substitutable with respect to others EGs and cannot, thus, impose upon them competitive constraints. CFE competes in a separate market, which consequently constitutes the relevant market of the product to conduct a "*benefit*" analysis.

7.1.2 The benchmark for a "benefit" analysis is the price included in the LTPA

31. The LTPA price for CFE is the appropriate benchmark for performing a "*benefit*" analysis under SCM Art. 14(d). Accordingly, under the equation there is no "*more than adequate remuneration*" arising from the purchase of CFE. The AB stated that prices can be used as a benchmark to determine a "*benefit*" when they are *market-determined*[185] and prices are not

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[180] *Ibid.,* 121.
[181] Case fact number 9.
[182] Clarification question number 94; IRENA, (2015), p. 30.
[183] Clarification question number no. 121.
[184] IEA (*2015)*, p. 17.
[185] ABR, *US- Carbon Steel (India),* para. 4.151.

distorted[186]. In turn, "*distortion*" has been defined as the situation "*when prices and production are higher or lower than levels that would usually exist in a competitive market*"[187]. The AB interpreted "*prevailing market conditions*" provided by SCM Art. 14(d) as the "*generally accepted characteristics of an area of economic activity in which the forces of supply and demand interact to determine market prices*"[188].

32. The FCPRE is a "*relevant rule of international law*" -within the meaning of Art. 31.3(c) of the VCLT- that enables to interpret the term *"prevailing market conditions",* since it recognizes that when suppliers do not internalize the costs generated from its production- *i.e.* the generation of carbon emissions- this amounts to *distortion*[189] in the market and, *ipso facto* excludes prices generated under that circumstances to be considered as appropriate benchmarks. On the contrary, under this interpretation, a price that corrects this type of distortions is the appropriate benchmark for conducting a "*benefit*" analysis with respect to SCM Art. 14(d). Indeed, Art. 3.2 of the DSU states that provisions must be interpreted or clarified "*in accordance with customary rules of interpretation of public international law*". Furthermore, "*It is well settled in WTO case law that the principles codified in Arts. 31 and 32 of the VCLT are such customary rules*"[190]. The FCPRE is a "*relevant rule of interpretation*" according to Art. 31.3(c) of the VCLT since: i) it is "*relevant*" as it regards the generally accepted characteristics of a market -the situation that costs need to be assumed by the party that produces them-; ii) it is an "*international rule*" since it is a treaty that imposes obligations to States and, thus, a source of international law in the sense of Art. 38 of the

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[186] ABR, *US – Softwood Lumber IV*, para. 103; ABR, *Antidumping and Countervailing Duties (China),* para. 439.
[187] "Distorted". WTO Glossary 2015. https://www.wto.org/english/thewto_e/glossary_e/distortion_e.htm. (8 January 2016).
[188] ABR, *US- Carbon Steel (India),* para. 4.150.
[189] Case fact number 1.
[190] ABR, *US - CVD (Germany)*, para. 61.

statute of the ICJS[191]; and iii) it is a treaty concluded between the Member States of the dispute. Regarding the interpretation of the term "*parties*" in Art. 31.3(c) of the VCLT, this provision should be interpreted as "*parties to the dispute*" for the sake of the principle of effective treaty interpretation[192], because other provisions of the VCLT[193] refer to "*all the parties*", whilst Art. 31.3(c) of the VCLT refers only to "*parties*".

33. Finally, the use of a non-WTO instrument is consistent with the "*principle of systematic integration*"[194] as it ensures that "*international obligations are interpreted by reference to their normative environment in a manner that gives 'coherence and meaningfulness' to the process of legal interpretation"*[195]. Specifically, the use of the FCPRE contributes to these objectives, as it permits the understanding of particular markets where negative externalities amount as distorting factors and, thus, enables a coherent and meaningful interpretation of terms such as "*benefit*" and *"more than adequate remuneration"* crucial to the subsidies discipline. In sum, the WEP is not a suitable benchmark for "*benefit*" determination due to the fact that it does not correct the imposition of a supplier-related cost to a third party, lowering artificially the price in the BEM. On the contrary, bearing in mind the LTPA does comprise apart from the WEP -M factor in the equation -an additional factor -X*Y[196]- that rewards the absence of carbon-emission -and thus corrects the absence of carbon-emission internalization-, it is suited to be the appropriate benchmark.

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[191] PR, *US-Gasoline,* para. 17.
[192] ABR, *Canada- Dairy,* para. 133.
[193] Arts. 31.2(a) of the VCLT.
[194] ILC Fragmentation, para. 413.
[195] ABR, *EC- Large Civil Aircraft,* para. 845.
[196] Case fact number 11.

34. Accordingly, if the equation contained in the LTPA is the appropriate benchmark it is *ipso facto* the necessary conclusion that the EEC did not purchased CFE for *"more than adequate remuneration"* as it determines the exact "*adequate remuneration"* under the SCM.

7.2 The LTPA is consistent with Art. 5(c) as it has not resulted in adverse effects

7.2.1 The LTPA is not the cause of the phenomena described in Art. 6.3(a) of the SCM

35. Displacement and impedance of imports coming from Borduria into Eriador are not caused "*but for*" the LTPA. Art. 5(c) provides that "*No Member should cause, through the use of any subsidy: (c) serious prejudice to the interests of another Member*," while Art. 6.3(a) determines that "*serious prejudice may arise (...) where (...): (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member.*" The AB stated: "*a subsidy causes a serious prejudice only when it is the genuine and substantial cause between the subsidies and the alleged market phenomenon*"[197]. One approach to scrutiny this situation is by means of a unitary approach using a "*but for test*"[198]. Furthermore, displacement and impedance[199] are qualified by the terms *"like product"* and "*market of the subsidizing Member*". To the AB this means: "*while a complaining Member may identify a subsidized product and the like product by reference to footnote 46, the products identified must be analyzed under the discipline of the product market so as to be able to determine whether displacement is occurring*".

36. The LTPA does not cause an adverse effect in the sense of SCM Art. 6.3(a) since: i) NRE coming from Borduria into Eriador does not compete in the same market as CFE and thus is not a like product in the *relevant market of the product* for the reasons set forth in section 3.1.1 ii) The

[197] ABR, *EC- Large Civil Aircraft,* para. 1232.
[198] *Ibid*., para. 1109; ABR, *US-Aircraft,* paras. 913-914.
[199] ABR, *EC- Large Civil Aircraft,* para. 1152.

displacement or impedance would have occurred "*but for*" the LTPA as NRE share in the global electricity markets are deemed to decrease significantly as a consequence of climate change. Indeed, climate change represents a challenge to modern societies and specific commitments, which translate in the undercutting of CO_2 emissions. This is the case of the Framework Convention emanated after the COP21, which states in its preamble that it is a goal towards 2020 –in a very similar approach to the FCPRE- that CO_2 levels are cut significantly to hold the global temperature below the 2ºC change[200]. In order to comply with these commitments, the IEA in terms of electric power points out that: a) CO_2 emissions must decrease from 35.8 to 31 Gt, which amounts to a 15% undercut[201], b) RE output must increase accordingly from 7000 to 13000 TWh –about 85%-[202] and to do so, c) it is indispensable to cut at least 30% of coal-fired electricity generation[203]. Accordingly, market shares of EB and BEC would have still been displaced and impeded "*but for*" the LTPA since climate change leaves States not alternative but to comply with CO_2 undercuts.

37. In sum, displacement and impedance of NRE imports coming into Eriador do not occur in the same relevant market of the like product –CFE- and also do not arise "*but for*" the LTPA as there are non-attribution factors[204] –climate change and international commitments- that would have resulted in the same economic phenomenon.

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[200] COP21 (2015).
[201] IEA *(2015)*, p. 17.
[202] *Ibid.*
[203] IEA (*2015)*, p. 31.
[204] ABR, *EC- Large Civil Aircraft,* para. 1233.

7.3 The LTPA is covered by the exception provided in Art. XX(d) of the GATT

7.3.1 GATT Art. XX is available to justify measures that breach the SCM

38. Measures that are found to be inconsistent with the SCM can albeit be justified by recourse to Art. XX of the GATT since there are contextual and other interpretative elements that establish an objective link amongst provisions of both treaties. The AB recognized "*that exceptions in one covered agreement, such as Article XX of the GATT 1994, may be invoked to justify a breach of an obligation set forth elsewhere than in the GATT 1994*"[205] even if no "*express language identifying the relationship between specific terms and provisions*"[206] is discernible. When this is so, the AB added: "*recourse to other interpretative elements will be necessary to determine the specific relationship among individual terms and provisions of the Multilateral Trade Agreements, and between such provisions and the Marrakesh Agreement.*"[207]

39. There is a specific relationship between the SCM and the GATT since the former elaborates the latter in the sense that the specific obligations imposed by Art. VI and XVI of the GATT and their terms are defined, developed and clarified by SCM. Art. XVI:1, for instance, imposes the obligation to refrain of causing "*serious prejudice"* to the interests of another Member. SCM disciplines this obligation by defining the term and explaining the circumstances where this may arise in Arts. 5 and 6. This relationship is not isolated and can be instead inferred from several provisions such as SCM footnote 13 and Art. 32.1 as well as relevant case law. For instance, the AB in *US- Countervailing Duties Investigation on DRAMS* stated: "*the object and purpose of the SCM Agreement is to strengthen and improve GATT disciplines relating to the use of both*

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[205] ABR, *China- Rare Earths,* para. 5.56.
[206] *Ibid.*
[207] ABR, *China- Rare Earths,* para. 5.56.

subsidies and countervailing measures"[208]. Thus, the context and the object and purpose of the SCM evidence a specific relationship between this Agreement and the GATT[209].

40. Having established such relationship between the treaties, Art. XX of the GATT shows as available to justify measures that breach the SCM. Indeed, GATT Arts. VI and XVI impose general obligations to Member States regarding subsidies and countervailing duties, which can only be disciplined by recourse of specific regulation by the SCM. Hence, if GATT Art. XX is available to justify breaches of GATT obligations under Arts. VI and XVI, the same conclusion should follow respect SCM provisions as they regard the same obligation –*i.e.* not to maintain subsidies that cause serious prejudice or are contingent on export-[210]. Furthermore, if it was concluded that Art. XX is not available to justify SCM violations, this would lead to absurd results for the following reason: "*A production subsidy, (...) has the virtue that it results only in a change of the production structure but not in the structure of consumption. (...) By contrast, tariffs, quotas and other border measures do not only impact the production structure, but also prices.*"[211] Accordingly, if it were accepted that GATT Art. XX exceptions are available to justify quantitative restrictions such as quotas and tariffs and not subsidies, this would amount to assert that a more trade restrictive and inefficient instrument can be justified whilst a less trade restrictive cannot or, in other words, that a more harmful instrument to the object and purpose of the WTO Multilateral System is justifiable but a more efficient and less harmful is not.

41. In sum, GATT Art. XX exceptions are available to justify a measure breaching the SCM provisions since a specific relationship can be drawn between both treaties. Thus, the exception of

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[208] ABR, *US- Countervailing Duties Investigation on DRAMS,* para. 115; ABR, *US-Antidumping and CVD (China),* para. 561.
[209] Art. 31.1 VCLT.
[210] IISD, CELA (2012), p. 10.
[211] *Ibid.,* p. 18.

Art. XVI of the GATT includes the provisions of the SCM since they amount to the same rights and obligations for Member States.

7.3.2 The LTPA is a measure that falls into exception XX(d) of the GATT

42. The LTPA is a measure justifiable under Art. XX(d) of the GATT insomuch as: i) it is "*necessary to secure compliance"* with Art. 11 of the FCPRE and, ii) it is not applied in a way that constitutes "*arbitrary or unjustifiable discrimination between countries where the same conditions prevail*"[212]. The AB has established that in order to justify provisionally a measure under Art. XX of the GATT, two substantive issues have to be satisfied by the respondent party: i) that the provision falls under the scope of one of the exceptions listed in the subparagraphs of Art. XX and, ii) that the *application* of that measure complies with the *chapeau* [213]. Regarding the first, Art. XX(d) of the GATT has two substantive elements that have to be met[214]; the measure has: i) to be designed to "*secure compliance with law or regulations which are not in itself WTO inconsistent*" and, ii) it must be "*necessary*" to achieve the objective alleged.

43. Regarding the second element, the LTPA was launched pursuant to "*secure compliance*" with Art. 11 of the FCPRE[215] and was designed and structured to do so. In Eriador, by 2010 the RE market share in the BEM was about only a 7%[216] and accordingly an increase of an additional 43% was needed in a period of ten years for ensuring compliance with the FCPRE. The LTPA provided LTC at higher prices for CFE produced that compared to those available in the BEM –the WEP-. This, in turn, was intended to increase CFE generation –a RE source- by promoting enhanced production. Thus, by awarding LTC at high prices the LTPA complies with the standard in GATT

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[212] Art. XX of the GATT.
[213] ABR, *US-Gasoline,* para. 22; ABR, *US-Shrimp* ; ABR, *EC- Seal*, para. 5.169.
[214] ABR, *Korea-Beef,* para. 157; ABR, *Thailand- Cigarettes (Philippines),* para. 177.
[215] Case fact number 11.
[216] *Ibid*., 13 and clarification question number 4.

Art. XX(d). The LTPA was awarded to secure compliance with *"laws or regulations*" since albeit the FCPRE is not part of the domestic legislation of Eriador[217], the AB established that even in such cases, when an international obligation has an effect on the domestic legal system of the Member State, the substantive element of Art. XX(d) of the GATT is met[218]. As Art. 11 of the FCPRE must be satisfied within the Eriadorian territory and a breach of the obligation would arise State responsibility[219] there is no need to further develop this element. Finally, the FCPRE is not in itself "*WTO inconsistent"* as it regards the compliance of an objective –the RE promotion- but without referring to means that would result in trade restriction in any of its forms –discrimination, technical barriers, etc.-.

44. Vis-à-vis the necessity test, the AB has established that a measure is "*necessary*" when the "*weighing and balancing test*" is satisfied[220]. This test requires that the measure: i) pursuits an important value. The LTPA pursuits to contain the effects of climate change by CFE promotion – the measure has the same overall objectives that the FCPRE[221]- whilst ensuring the long-term sustainability and stability of the electricity system in Eriador; ii) contributes to achieve the objective pursued –in the context of exception XX(d) the objective pursued is compliance of the FCPRE and not the ultimate value that the latter pursues-. The AB insisted that this requisite entails a "*certain minimum threshold such as a material or significant contribution*"[222]. Since the FITS as a programme has achieved in three years an absolute increase of RE procurement of 34% -from 7% in 2012 to 41% in 2015- and bearing in mind the objective to 2020 is of 50%, the contribution amounts as significant or material iii) is the least trade-restrictive available instrument for Eriador.

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[217] Clarification question number 122.
[218] ABR, *Mexico-Taxes on Soft Drinks,* footnotes 148 and 152.
[219] ILC (2001), Art. 1.
[220] ABR, *Canada- Wheat Exports and Grain Imports,* paras. 6.223-6.224; ABR, *EC- Seal,* para. 5.169.
[221] Clarification question number 103.
[222] ABR, *EC- Seal,* para. 5.209.

However, the AB identified that when a measure is not trade restrictive the evaluation of alternatives is not necessary[223]. This is the case of the FITS because the program as such does not impose a ban or a restriction to NRE but it is directed to *promote* CFE, a design that cannot be found to be restrictive as such. In the alternative, Eriador underscores that *all* available measures –*i.e.* tax exemption for RE producers- would have the same result since the promotion of RE in a market represents a displacement of the existing player that foregoes its share.

45. Finally, the LTPA complies with the *chapeau* of GATT Art. XX. Albeit the LTPA differentiates between CFE and other sources of electricity this in itself does not amount to *arbitrary or unjustifiable discrimination,* since it encompasses reasonably with the policy objective pursued in the light of Art. XX(d) of the GATT[224]–the halt of climate change by stable and sustainable RE promotion- and is not applied respective of the country of origin of NRE[225]. Indeed, the AB stated "*One of the most important factors in the assessment of arbitrary or unjustifiable discrimination is the question of whether the discrimination can be reconciled with, or is rationally related to, the policy objective with respect to which the measure has been provisionally justified"*[226]. There is no discrimination arising by the *application* of the FITS since the promotion of CFE is accord with the purposes of halting climate change due to its capability of zero CO_2 emissions but also since CFE provides high reliability and stability –qualities that are not achieved by other RE technologies-. Additionally, differentiation between CFE and NRE arises not from the origin of the product but rather its rational is founded in the characteristics of CFE as

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[223] ABR, *EC- Seal,* footnote 1181; ABR, *US- Tuna II (Mexico),* footnote 647.
[224] *Ibid.,* para. 5.306.
[225] ABR, *US – Shrimp*, para. 165; ABR, *EC- Seal,* para. 5.306.
[226] ABR, *Brazil – Retreaded Tyres*, paras. 227, 228, and 232.

a product, since: i) CFE has significant positive externalities[227], and ii) is reliable and capable of achieving high dispatchability and meet any needs the EEM requires.

46. In sum, the LTPA is covered by the exception provided in Art. XX(d) of the GATT as it is "*necessary to secure compliance"* with the FCPRE and it is *applied* in a way that it is not inconsistent with the *chapeau* of Art. XX of the GATT.

Request for Findings- Conclusion

In light of the above, Eriador respectfully requests the Panel advise the DSB to:

1. *Find* that the IFFG is consistent with Art. 3.1(a) of the SCM.
2. *Find* that the IFFG is not a specific subsidy within the terms of Art. 2 of the SCM Agreement and is therefore not an actionable subsidy subject to the provisions of part III of the same Agreement.
3. *Find* that the IFFG is consistent with Art. 5(c) of the SCM as it does not cause serious prejudice in the sense of Art. 6.3(c) of the SCM.
4. *Find* that the EL is outside the scope of the SCM as Eribank is not a "*public body*" and as a consequence the measure is not a "*subsidy*" within the terms of Art. 1.1 of the SCM.
5. *Find* that the EL is consistent with Art. 5(c) as it does not cause serious prejudice in the sense of Art. 6.3(c) of the SCM.
6. *Find* that the LTPA is outside the scope of the SCM Agreement as it is not a "*subsidy"* within the meaning of Art. 1.1 of the SCM so long as it does not confer a "*benefit*".
7. *Find* that the LTPA is consistent with Art. 5(c) of the SCM as it does not cause serious prejudice in the sense of Art. 6.3(a) of the SCM.

[227] Case fact number 5.

8. *Find* that the LTPA is covered by the exception XX(d) of the GATT as it is "*necessary to secure compliance*" with Art. 11 of the FCPRE

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emc² ELSA moot court competition

elsa The European Law Students' Association

Annex A- SUBMISSION OF THE COMPLAINANT

Foreword: This Annex contains the Complainant written submission for the same case ("*Eriador-Certain Measures Affecting the Electricity Sector*"). The purpose of doing so is to provide the reader with the full extent of the case resolution and to enhance and strengthen the legal discussion therein. The Respondent's submission is included in the text of this thesis since the authors consider this submission has a greater juridical interest for readers.

Team: [046]

ELSA MOOT COURT COMPETITION ON WTO LAW

2016

Eriador-Measures Affecting the Electricity Sector

Borduria

(Complainant)

v.

Eriador

(Respondent)

SUBMISSION OF THE COMPLAINANT

Summary of Arguments

4. The IFFG breaches Art. 3.1(a) of the SCM

- The IFFG is a "*subsidy*" within the meaning of Art. 1.1 of the SCM since it is: i) a "*financial contribution*" –in the form of direct transfer of funds-, ii) granted by a "*government",* and iii) confers a "*benefit*" to the recipient as it is a non-refundable payment.
- The GOE anticipated "*exportation or export earnings*" of sales of FFSS arising from the IFFG since the future business plans submitted by FE included the construction of a second FSPF which would result in the increase of exports of FFSS insofar as FE was not willing to sell or license the FS to any EG operating in Eriador.
- The IFFG was "*tied to*" actual or anticipated exportation or export earnings as it induced FE to demonstrate a potential growth in its export performance so that it could evidence a "*significant contribution*" to the global integration of the Eriadorian economy. Also, the export ratio increased dramatically as FE exportations grew significantly, thus complying with the test established by the AB.

5. The IFFG and the EL breach Arts. 5 (c) and 6.3(a) ofthe SCM

- The IFFG and the EL are specific subsidies within the meaning of Arts. 1.1 and 2 of the SCM
- The IFFG is a subsidy as it is a *"financial contribution" –i.e.* a grant-, awarded by the government of Eriador, that confers a benefit; and is "*specific*" as it is predominantly used by certain enterprises operating in the RE sector.
- The EL is a "*subsidy*" within the meaning of Art. 1.1of the SCM since:
  - A "*financial contribution*" was granted in the form of a direct transfer of funds.
  - It is granted by a "*public body"* since Eribank performed *governmental functions* by promoting financially projects that were strategic to the Eriadorian state.
  - Alternatively, the "*financial contribution"* was granted *indirectly* by the GOE, as it entrusted or directed Eribank to grant the loan to CT.
  - A benefit is conferred since the loan was granted on favorable terms.
- The IFFG and the EL caused serious prejudice to Borduria within the meaning of Arts. 5(c) and 6.3(c) of the SCM since:
  - The lost sale of solar panels in Carpathia would have not occurred "*but for*" the subsidy since CT would not have been able to launch the FS division and sell it to FE before the reference period.

- In a second scenario, the lost sale of solar panels in Carpathia would not have occurred but for the subsidy, as FE would not have acquired the economies of scale that enabled it to offer the large discount to Elektrica.
- The lost sale was significant as the Carpathian market was of *"strategic interest",* and occurred in the same market as FFSS and solar panels exercise competitive constraints on each other since they are substitutable.

6. The LTPA is inconsistent with Arts. 5(c) and 6.3(a) of the SCM

- The LTPA is a specific "*subsidy*", since:
  - The LTPA is a "*financial contribution"* in the form of purchase of goods as it involves the transfer of an entitlement to electricity in exchange for a monetary payment.
  - It is granted by a *"public body"* as the EEC is a governmental agency that performs governmental functions.
  - A benefit is conferred since the purchase of electricity is made for *"more than adequate remuneration"*.
  - The relevant market is the BEM as CFE is capable of imposing competitive constraints to other EGs operating in Eriador; and the appropriate benchmark is the WEP as it is *market determined,* and arises from the BEM.
  - The LTPA provides more than adequate remuneration as compared to the WEP since it provides a significantly higher price than the one available in the in-country market for the good in question
  - The LTPA is *de jure* specific within the meaning of Art. 2.1(a) of the SCM the legislation pursuant to which it is granted explicitly limits the access to certain enterprises –namely CFE EGs-.
- The LTPA causes serious prejudice to the interests of Borduria since the effect of the subsidy is displacement and impedance of imports of electricity coming from Borduria.
  - CFE and electricity imported from Borduria are "*like products*" as they are identical.
  - The displacement and impedance of electricity imports coming from Borduria into Eriador would not have occurred *"but for*" the LTPA since it was for the high costs of maintaining the LTC that the five contractual arrangements with the Bordurian enterprises were not renewed.
- The exceptions provided by Art. XX GATT are not available to justify a breach under the SCM since there is no nexus between the former and the latter. Also, the measures would not be

justifiable because they do not comply with the *chapeau* of Art. XX GATT

Identification of WTO Measures at Issue

Measure 1: The IFFG, a $500m grant under the GOE IFFP, which seeks to provide financial assistance to projects which promise to make a significant contribution to the sustainable growth and global integration of the Eriadorian economy.
Measure 2: The EL, a $750m loan on favourable terms disbursed by Eribank, a SOCB.
Measure 3: The LTPA concluded between FE and the EEC under the FITS, implemented pursuant to a Direction from the Ministry of Commerce, which sought to increase the supply of electricity from CFE. It provided a guaranteed price under the formula C=M+X*Y, a significantly higher price compared to the WEP.

Legal Pleadings

1. The IFFG breaches Art. 3.1(a) of the SCM

1. The IFFG is inconsistent with Art. 3.1(a) of the SCM. This provision prohibits *"subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I"*, whilst footnote 4 of such provision sets the standard for determining de facto export contingency[228]. Furthermore, Art. 2.3 of the SCM provides that *"[a]ny subsidy falling under the provisions of Article 3 shall be deemed to be specific"*; meaning that the issue of specifity should not be addressed separately[229]. Finally, the AB has indicated that the fulfilment of the standard for determining de facto export contingency requires evidence of three elements, namely: i) the *"granting of a subsidy"*; ii) *"actual or anticipated exportation or export earnings"*; and iii) that the subsidy was *"tied to"* export anticipation[230]. Borduria submits that all three elements are met.

1.1. A *"subsidy"* was granted

2. The IFFG is a subsidy within the meaning of SCM Art. 1.1, which establishes that a "*subsidy*" exists if there is: i) a "*financial contribution*" ii) granted by a *"government or a public body"* within the territory of a Member; and iii) a *"benefit"* is thereby conferred. Furthermore, the AB

[228] ABR, *Canada- Aircraft,* para. 108; ABR, *EC- Large Civil Aircraft,* para. 1036
[229] PR, *US-FSC*, footnote 114; PR, *Canada-Autos*, para. 10.172
[230] ABR, *Canada- Aircraft*, para. 169-172

has considered that a benefit has been conceded when the "*financial contribution"* places the recipient in a better-off position than it would have otherwise been without it[231].

3. The IFFG complies with all the above-said elements since: i) The IFFG is a *"financial contribution"* as something of economic value is transferred[232] and grants are treated as a *"financial contribution"* under Art. 1.1(a)(1)(i) of the SCM; ii) it was granted by a "*government*", since the program pursuant to which the grant was awarded, was of a governmental nature[233]; and iii) a "*benefit*" was conferred since the grant placed the recipient in a better-off position, as the *"financial contribution"* constituted a non-refundable payment –which "*as a usual matter"*[234] results in a "*benefit*" for the recipient-.

4. Hence, the IFFG is a subsidy within the meaning of Art. 1.1 of the SCM as it is a *"financial contribution"* granted by a government, which confers a benefit.

1.2. The GOE anticipated exportation or export earnings

5. The GOE anticipated "*exportation or export earnings"* as it expected that exports of FFSS would rise because of the IFFG. The AB has explained that in order to determine if exportations were anticipated, the relevant enquiry is *"whether the granting authority expected exports to ensue or arise out of the granting of the subsidy*"[235]. Moreover, the AB clarified that *"[w]hether exports were anticipated or 'expected' is to be gleaned from an examination of objective evidence"*[236].

6. FE did not sell or license FFSS to other EGs operating in Eriador to safeguard its position as market leader in the CFE[237] commercialization. This meant that the remainder of the production of FFSS that was not reserved for its own use by incorporating them in their power plants would be exported. The GOE had knowledge of this situation since FE made its case as an applicant to the IFFP by submitting its business plans, which included the construction of an additional FSPF[238]. Thus it was expected that exports would rise as a consequence of enhanced production. Furthermore, the GOE expressed that it was convinced "*of the potential significance of exports of FFSS for the Eriadorian economy"* before awarding the grant[239]. It was expected, thus that the

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[231] *Ibid*., paras. 157-158
[232] ABR, *US-Softwood Lumber IV*, para. 51
[233] Case fact number 10
[234] PR, *Brazil-Aircraft (Article 21.5—Canada II),* paras. 5.27-5.28
[235] ABR, *US- Aircraft,* para. 7.1533
[236] ABR, *Canada-Aircraft*, paras. 169-172
[237] Case fact number 8 and Clarification question number 1
[238] Clarification question number 22
[239] Case fact number 10

GOE had in mind that if it awarded the IFFG to FE, the increase in supply of FS would escalate the exports of the device since there was no domestic market for them.

7. Hence, with an expected increase of the total production of FFSS after the construction of the additional FSPF, and bearing in mind the absence of supply of FFSS in the domestic market, the GOE anticipated that exports would arise from the IFFG.

1.3.The IFFG was *"tied to anticipated exportation or export earnings"*

8. The IFFG was *"tied to"* anticipated exportation or export earnings, since it sought to induce the promotion of FFSS exports. The AB has determined that a relationship of conditionality must be verified[240] and that it is not necessary that such relationship is expressly or by necessary implication provided in the terms of the instrument granting the subsidy[241]. Furthermore, in *Canada-Aircraft* the AB provided the following test in order to determine the conditionality relationship: "*is the granting of the subsidy geared to induce the promotion of future export performance by the recipient?*"[242] Additionally, the AB determined that the latter analysis should include an examination of the design, structure and modalities of operation of the measure[243].

9. Regarding the design of the measure, Borduria asserts that the IFFP offered financial assistance only to projects, which promised to make "*a* ***significant contribution*** *to the sustainable growth* ***and global integration of the Eriadorian economy***"[244]. Moreover, as to the structure and modalities of operation of the IFFG, applicants had to "*convince the Eriadorian government that they ought to be given an award*" by providing relevant information "*emphasizing its contribution to the goals of the program, and its specific plans for the grant money sought*"[245].

10. When FE sought to persuade the GOE of its contributions to the goals of the IFFP, it was evident that its FS contributed to the Eriadorian "*sustainable growth*" since the device was a substantial part of CFE production –a type of electricity produced without toxic by-products[246] that helps reverting the effects of climate change[247]-. Nevertheless, the program induced FE to demonstrate a potential growth in its export performance so that it could evidence a significant contribution to the global integration of the economy. Pursuant to achieve this, FE included in its

[240] ABR, *Canada-Aircraft*, para 171
[241] *Ibíd*., para 1044
[242] ABR, *EC-Large Civil Aircraft,* para. 1044
[243] ABR, *Canada-Aircraft*, para. 1046
[244] Case fact number 10 (Emphasis added)
[245] Clarification question number 22
[246] Case fact number 5
[247] IEA (2015*)*, p. 17

future business plans the construction of a second FSPF that would increase its production of FFSS and enable FE to export a significant volume of devices. Indeed, an enterprise in Eriador would be able to contribute to the global integration of the economy by creating a new GVC of CFE. A GVC "*links geographically dispersed activities in a single industry*"[248]. FE achieved this by exporting FFSS abroad, since it would foment interactions between Eriador and all the FS importers, as CFE is generated through a complex technology[249] that would require provisions not only of goods, but also a constant provision of services associated with the installation, maintenance and functioning of the technology.

11. To reinforce the previous conclusion, the AB in *EC-Large Civil Aircraft* established a test in order to determine when a subsidy is presumably aimed to encourage export performance; this consists on comparing the *ratio* of domestic and export sales before and after the granting of the subsidy[250].

12. After receiving the subsidy, FE has expanded its exports sales massively[251], selling FFSS to over 50 countries worldwide, exporting the "*vast majority of the additional production of the second FSPF"*[252]. On the other hand, the domestic supply for FFSS remains null, since FE still refuses to sell them domestically, and there is no evidence that indicates that it has constructed more electricity plants that would require additional reservations of FFSS, as it had already integrated the FS to all its power generation facilities[253]. Therefore, the comparative analysis proves that the export *ratio* has increased; meaning also that the IFFG was aimed to encourage FE's export performance.

13. Hence, the IFFG induced the promotion of future export performance, since it was because of the application of FE to the IFFP, that it decided to include in its business plans the construction of a second FSPF that would enable it to increase its exports, as it was the way to demonstrate that it could make a significant contribution to the global integration of the Eriadorian economy.

2. The IFFG and the EL breach Arts. 5(c) and 6.3(a) of the SCM

14. Eriador breached Art. 5 of the SCM as it caused adverse effects to the interests of Borduria through the use of the IFFG and the EL. Art. 5 of the SCM reads that "*no member should cause,*

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[248] De Baker (2013)
[249] Case fact number 5
[250] ABR, *EC-Large Civil Aircraft*, paras. 1046-1048
[251] Case fact number 12
[252] Clarification question number 33
[253] Case fact number 8

through the use of any subsidy(...)*, adverse effects to the interests of other Members, i.e.: (...) (c) serious prejudice to the interests of another Member"*. Furthermore, Art. 6.3 state that "*serious prejudice in the sense of paragraph (c) of Art. 5 may arise in any case where (...) (c) the effect of the subsidy is a significant price undercutting* (...) *or* ***lost sales*** *in the same market"*[254]. Accordingly, for a measure to be challenged under SCM Arts. 5 and 6, it must be a specific subsidy[255].

1.1.The IFFG and the EL are specific subsidies

1.1.1. The IFFG is a specific subsidy within the meaning of the SCM

15. The IFFG is a subsidy for the reasons explained in Section 1.1, and is also *de facto* specific. Art. 2.1(c) of the SCM provides that, notwithstanding any appearance of non-specificity derived from the legislation pursuant to which the granting authority operates "*there are reasons to believe that the subsidy may in fact be specific, other factors may be considered"*. One of such factors is the "*predominant use* [of a subsidy] *by certain enterprises",* which "*may be simply understood to be a situation where a subsidy programme is mainly, or for the most part, used by certain enterprises"*[256].

16. The IFFP has been used mainly by certain enterprises, since 90% of the funds disbursed have been directed to enterprises operating in the RE sector[257]. Additionally, Eriador is a highly diversified and industrialised economy[258] and the IFFP has been running for over five years -a sufficient time lapse that permits an undistorted specificity analysis according to the last sentence of Art. 2.1(c) of the SCM-.

17. Hence, the IFFG is in fact a specific subsidy as it has been used predominantly by enterprises operating in the RE sector. As a result, it is subject to the provisions of part III of the SCM.

1.1.2. The EL is a specific subsidy within the meaning of the SCM

(i) *The EL is a "financial contribution"*

18. The loan constitutes a *"financial contribution"* in the form of direct transfer of funds, as it is one of the cases set via example by article 1.1(a)(1)(i) of the SCM.

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[254] Emphasis added
[255] PR, *US-Upland Cotton,* paras. 7.1109-7.1110
[256] PR, *EC-Large Civil Aircraft,* para. 7.974
[257] Case fact number 10
[258] Case fact number 1

(ii) *Eribank is a "Public Body"*

19. Eribank is a "*public body*" as it exercised governmental functions. According to the AB, a "*public body*" -as mentioned in article 1.1(a)(1) of the SCM- is an "*entity that possesses, exercises or is vested with governmental authority"*[259]. It emphasized that a "*public body*" does not necessarily posses "*the power to regulate, control, supervise individuals, or otherwise restrain conduct of others*" in order to be found to be "*vested with governmental authority* ***or exercising a governmental function and therefore to constitute a public body***"[260] .

20. In this sense, an entity may be found to be a "*public body*" for exercising governmental functions such as *promoting* financially activities amongst private individuals that may serve to comply with strategic State policies or objectives. These are the *governmental functions* Eribank performed. This is evidenced by the fact that Eribank was required by its constitution "*to conduct its business 'having regard to the strategic policy priorities of the Eriadorian State'* and *'in consultation, as appropriate, with relevant government ministries*"[261]. Accordingly, the EL transaction provides context to understand how these general obligations led Eribank to exercise *governmental functions*.

21. In the EL transaction, CT turned to Eribank for financial assistance as it was unable to obtain funds for the FS project from private investors due to its extremely high risk profile, unproven nature of the technology, uncertainty concerning the anticipated costs of electricity generation and the huge capital investment needed[262]. All of these reasons made the project commercially unreasonable. Eribank, as required by its constitution, consulted the Eriadorian Ministry of Environment, which expressly supported the loan. It was likely that Eribank would follow this opinion since directors would be in violation of the law[263] if they failed to conduct business regarding the State policies. Finally, and above all, Eribank not only disbursed funds to a commercially unreasonable project, but it did so on "*favourable terms*".

22. The foregoing facts prove how the constitution of Eribank led it to perform governmental functions by promoting strategic projects to Eriadorian policies through providing financial

[259] ABR, *US-Antidumping and Countervailing Duties (China),* para.317; ABR,*US-Carbon Steel (India),*para.4.17
[260] ABR, *US-Carbon Steel (India),* para. 4.17 (emphasis added)
[261] Case fact number 6
[262] *Ibid*.
[263] Clarification question number 126

assistance. In sum, Borduria has proven that Eribank conducted a *governmental function*, namely the promotion of RE technologies, and is therefore a *"public body"*.

23. The fact that Eribank was under meaningful control of the GOE reinforces the above said conclusion. The AB has established that it is indicative of the existence of a "*public body*" when the government controls the entity to a meaningful extent[264]. Moreover, the Panel in *US- Carbon Steel (India)* emphasized that the fact that the entity was majority owned by the government and that members of the board of directors were appointed by it was of great importance to surmise the presence of control[265].

24. Eribank is under meaningful control of the GOE as it is an entity majority owned by the GOE, and its board of directors are appointed by the GOE[266]. Hence, this evidence reinforces the conclusion that Eribank is a "*public body"* within the meaning of the SCM

25. Alternatively, Borduria states that the GOE granted indirectly a *"financial contribution*" as it entrusted or directed Eribank to offer the EL. According to Art. 1.1(a)(1)(iv) of the SCM –in essence an anti-circumvention provision[267]-, a *"financial contribution"* may also be provided indirectly[268] where a government "*entrusts or directs a private body to carry out one or more of the type of functions (...) illustrated in (i) to (iii) [...] which would normally be vested in the government and the practice, in no real sense, differs from practices normally followed by governments"*. The AB has considered that "*entrustment*" occurs *"where a government gives responsibility to a private body"*, and *"'direction' refers to situations where the government exercises its authority over a private body",* noting that, usually, guidance can constitute direction[269]. Furthermore, there must be a demonstrable link between the government and the conduct of the private party[270], but the SCM does not require that the entrustment or direction of a government be conveyed in a particular manner[271]. This link may be proven by circumstantial evidence, considering the interaction of certain pieces of evidence that *may justify certain inferences that could not have been justified by a review of individual pieces of evidence in*

[264]ABR, *US-Antidumping and Countervailing Measures (China),* para. 318
[265] PR, *US-Carbon Steel (India),* para. 7.85
[266] Case fact number 6
[267]ABR, *US – Softwood Lumber IV*, para. 52; ABR, *US-Countervailing Duty Investigations on DRAMs,* para. 113
[268]ABR, *US-Countervailing Duty Investigations on DRAMs,* para. 108
[269]*Ibid.,* para. 116
[270]*Ibid.,* para.113; PR, *US-Countervailing Measures (China),* para. 7.402.
[271]PR, *EC-Countervailing Measures on DRAM Chips,* para. 7.57

isolation[272]. Finally, the AB has recognized that, in most cases, entrustment or direction is expected to involve some form of threat or inducement[273], and that "*commercial unreasonableness of the financial transactions is a relevant factor in determining government entrustment or direction under Article 1.1(a)(1)(iv) of the SCM*"[274].

26. In the specific case, Eribank –a SOCB that is run largely on a commercial basis-, was approached by CT, an enterprise operating in the RE sector, who sought funds to develop an **extremely high risk profile project**[275], and for that reason was unable to obtain such funds either from private investors, **or from any other market source**[276]. Eribank not only disbursed the funds, but did so on "*favourable terms*". There is no commercial reasonableness underlying this behaviour; on the contrary, it can only be explained with the entrustment or direction of the GOE to Eribank. The GOE has a primary policy objective to move its economy towards full reliance on RE sources[277]. Furthermore, it is able to control the decisions of Eribank as it is the majority shareholder, and appoints the totality of the board of directors, which is evidenced by the fact that Eribank is also separately used on occasion as a vehicle through which the GOE disburses funds to Eriadorian businesses under government grant programs. Hence, the GOE exercised its control over Eribank to provide indirectly a favourable loan to CT in order to comply with its objective to move towards full reliance on RE sources by promoting importantly the development of new electricity sources. The latter is also evidenced by the express support given to the loan by the Eriadorian Ministry of the Environment. This support was not a mere policy pronouncement, but rather provided inducement to perform the direct transfer of funds: The directors had to regard the strategic policy priorities of the Eriadorian state since, if they failed to do so, they would violate the constitution of the bank –and therefore the law-[278]; in this sense, it is to be expected that the recommendations of a Ministry will be followed by the directors to avoid any possible illegality.

27. Finally, the EL was commercially unreasonable, which is indicative evidence and a relevant factor in determining "*entrustment*"[279]. CT was unsuccessful in obtaining funds from private investors due to the project "*extremely high risk profile, the unproven nature of the technology,*

[272] ABR, *US-Countervailing Duty Investigations on DRAMs,* para. 157
[273]*Ibid.,* para.116
[274] ABR, *Japan-DRAMs (Korea),* para. 138
[275] Case fact number 6 (emphasis added)
[276] Clarification question number 84 (emphasis added)
[277] Case fact number 1
[278] Clarification question number 98
[279]ABR, *Japan-DRAMs (Korea),* para.138

uncertainty concerning the anticipated costs of electricity generation using the technology, and the huge capital investment needed"[280]. However, Eribank not only granted the loan, but did so on favourable terms[281], which indicates no underlying commercial reason.

28. Hence, the GOE made a *"financial contribution"* indirectly, as it entrusted Eribank to provide a loan to CT.

(iii) *The EL conferred a benefit to FE*

29. The EL was made on "*favourable terms*", in the sense of being on terms more favourable to anything that would normally have been available on the market[282]. Furthermore, Eriador made clear that it does not contest that the EL would confer a benefit if granted by a public body. Therefore, the EL conferred a benefit to FE.

(iv) *The EL is a specific subsidy*

30. The EL is a specific subsidy as it was granted to a specific company. The Panel in *Japan-DRAMS (Korea)* recognized that a financial contribution in an individual transaction could become specific when it did not flow "*from a generally available support programme whose normal operation would generally result in financial contributions on predetermined terms*", but rather *"requires conscious decisions as to whether or not provide the financial contribution to one applicant or another"*[283].

31. The EL *"was simply one such loan, and was not awarded as part of a broader scheme"*[284]; rather, Eribank –in the course of its normal activities- makes loans to businesses either on standard or in negotiated terms between the bank and the borrower. Hence, the EL is a specific subsidy as it was an individual transaction to a specific company.

32. For all the reasons stated before, the EL is a specific subsidy within the meaning of Arts. 1.1 and 2 of the SCM.

1.2. The IFFG and the EL caused serious prejudice to Borduria within the meaning of Art. 5(c) of the SCM

33. The EL and the IFFG caused serious prejudice to the interests of Borduria, as the lost sales of solar panels were the effect of the subsidies. Art. 6.3(c) of the SCM establishes that serious

[280] Case fact number 6
[281] *Ibid*.
[282] Clarification question number 84
[283] PR, *Japan-DRAMS (Korea)*, para. 7.374
[284] Clarification question number 71

prejudice within the meaning of Art. 5(c) of the SCM may arise where "*the effect of the subsidy is a significant price undercutting* (...) *or* ***lost sales*** *in the same market"*[285]; Additionally, the AB stated that "*there would be lost sales where the counterfactual analysis shows that, in the absence of the challenged subsidy, sales won by the subsidized firm(s) of the respondent Member would have been made instead by the competing firm(s) of the complaining Member"*[286]. One possible approach for this assessment is *"an inquiry that seeks to identify what would have occurred "but for" the subsidies*"[287]. Finally, it should be concluded from the considerations made by the Panel in *Korea-Commercial Vessels* that the determination of "*like product*" is not a legal requirement for claims of "*lost sales*"[288].

34. ST signed a MOU with Elektrica for the supply of 40.000 solar panels in late 2012. However, Elektrica broke off negotiations in their final stages, informing that they had decided to refocus their investments towards the creation of CFE on the basis of price, as FE had approached them with an offer for the sale of FFSS at 50% off their normal price. Borduria submits two counterfactual scenarios to evidence that ST would have achieved the sales of solar panels "*but for"* the subsidies.

35. In a first counterfactual scenario, CT would not have been able to develop the FS and sell it to FE before the reference period "*but for"* the subsidy. They sought to obtain funds for this project, but none could be obtained from private investors –or from any other market source[289]- due to the *extremely* high-risk profile of the project. Thus, CT would not have obtained financing to construct the initial FSPF was it not for the EL, which means in turn that the FS division would have never been launched. Hence, without the FS being launched to the market, the sales of solar panels would not have been lost *"but for"* the subsidy.

36. In a second counterfactual scenario, even if CT managed to obtain financing and sell the division to FE before the reference period, the latter would not have been able to offer the reduced prices that persuaded Elektrica to break off negotiations with the former. Indeed, FE felt able to extend such a large discount since its production costs had fallen dramatically as a result of lessons learnt over the years since it started to manufacture FFSS, and as a result of economies of scale

[285] Emphasis added
[286] ABR, *EC-Large Civil Aircraft,* para. 1220
[287] *Ibid.*, para. 1233
[288] PR, *Korea-Commercial Vessels,* para. 7.554
[289] Clarification question number 84

achieved through the addition of the second FSPF[290]. FE would not have acquired the economies of scale it did *"but for"* the IFFG, as the second FSPF would not have been built were it not for the measure[291]. Hence, in absence of the subsidies, FE would not have been able to offer the discount, and would not have persuaded Elektrica to disregard the MOU signed with ST.

37. Finally, the lost sale was "*significant"* as interpreted by the AB[292], since the Carpathian market was regarded as of "*strategic importance*"[293]. It also occurred *in the same market* –the REGE market in Carpathia- as FFSS and solar panels exercise a competitive constraint on each other[294] due to the fact that they are substitutable[295]: Indeed, both devices have the same end-uses, as both are able to generate electricity through a carbon-free process. Substitutability is also evidenced by the fact that Elektrica switched to the generation of CFE on the basis of price[296].

38. In conclusion, the EL and the IFFG caused serious prejudice to the interests of Borduria as ST would have won the sale of REGE instead of FE, in absence of the challenged subsidies, complying with all the elements present in Art. 6.3(c)

3. The LTPA is inconsistent with Arts. 5(c) and 6.3(a) of the SCM

39. Eriador has breached its obligations under the SCM as it caused adverse effects to Borduria with the implementation of the LTPA. Art. 6.3(a) states that serious prejudice –and thus adverse effects- may arise where "*the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member".*

3.1 The LTPA is a specific "*subsidy*" under Arts. 1.1 and 2 of the SCM

40. The LTPA is a *"subsidy"* as it embodies the elements set forth in Art. 1.1 of the SCM, and is *de jure* specific as provided by Art. 2 of the SCM.

3.1.1 The LTPA is a "financial contribution" granted by a "public body"

41. The LTPA complies with the first two elements listed in section 1.1 as it is a "*financial contribution*" in the form of a "*purchase of goods*" made by the EEC, a "*public body*". First, the LTPA is a *"financial contribution"* in the form of "*purchase of goods*" as it involves the transfer of an entitlement to the product –electricity- in exchange for a monetary payment[297]. Second, the

[290] Clarification question number 10
[291] Clarification question number 6
[292] ABR, *EC-Large Civil Aircraft,* paras. 1219
[293] Clarification question number 10
[294]ABR, *EC-Large Civil Aircraft,* para. 1120
[295] *Ibid*., para. 1219
[296] Case fact number 14
[297] PR, *Canada- Renewable Energy,* paras. 7.227-7.229

"*purchase of goods*" is made by a "*public body*" since EEC is a governmental agency[298] that exercises *governmental functions*[299] –namely administering the day-to-day functioning of the grid and regulating the entire supply[300]-. Thus, it should be concluded -as the Panel did in *Canada-Renewable Energy*[301]- that the functions developed by the ECC prove the existence of a "*public body"* and that the LTPA constitutes a *"financial contribution"* in the form of "*purchase of goods"*.

3.1.2 A "benefit" is conferred through the price equation comprised in the LTPA

42. The LTPA confers a "*benefit*" to FE. Art. 1.1 of the SCM provides that: "(...) *a subsidy shall be deemed to exist if:* (...) *a benefit is thereby conferred".* Accordingly, the AB established that a "*benefit*" *will* arise when the measure places the recipient in a more advantageous position than it would have otherwise been without it[302]. Furthermore, when a financial contribution is made in the form of a "*purchase of goods*", a "*benefit*" will only arise when the purchase is made for "*more than adequate remuneration in the prevailing market conditions within the country of the purchase"*. The former exercise involves a comparison with a market benchmark[303], making the definition of the relevant market a prerequisite to perform the benefit analysis –as the AB has insisted-[304].

(i) *The relevant market is the BEM and the WEP is the appropriate benchmark*

43. The BEM is the relevant market to perform the "*benefit*" analysis, and the WEP is the appropriate benchmark. According to the AB, when addressing the relevant market definition for the purposes of Art. 6.3(a) of the SCM, both demand-side and supply-side considerations should be taken into account[305]. This enquiry seeks to determine whether the products at issue exercise a *competitive constraint* on each other[306]. To fulfill this task, the EC guidelines[307] are useful. The EC has stated that the relevant market consists of two elements: i) the *relevant market of the product* and, ii) the *geographical market*[308]. The relevant geographic market *"comprises the area*

[298] See Case fact number 2
[299] ABR, *US- Anti-dumping and Countervailing measures (China),* para. 318
[300] Case fact number 2 and clarification question number 139
[301] ABR, *Canada- Renewable Energy,* para 7.239
[302] PR, *Canada- Aircraft,* para. 9.112
[303] ABR, *Canada- Renewable Energy,* para. 5.183
[304] *Ibid*., para. 5.169
[305] ABR, *EC- Large Civil Aircraft,* para.1121; ABR, *Canada- Renewable Energy,* paras. 5.170-5.172
[306] *Ibid.,* para. 1120
[307] EC. (1997)
[308] *Ibid*., para. 2

in which the undertakings concerned are involved in the supply and demand of products"[309] – which in this case is the market of Eriador, as all EGs are competing to supply the Eriadorian electricity grid[310]-, while the relevant product market "*comprises all those products* [...] *which are regarded as interchangeable or substitutable by the consumer, by reason of the products' characteristics, their prices and their intended use"*[311].

44. Electricity -regardless its source- is physically identical[312], has the same characteristics and end-uses. Therefore, if hypothetically one EG was to make a small but significant increase in its price[313], the customer would immediately switch to available substitutes –*i.e.* electricity produced by other EGs-, rendering the price increase unprofitable. Hence, from the point of view of demand substitution, all kinds of electricity shall be deemed as substitutes that are included in the same relevant market –the BEM-[314].

45. Furthermore, taking into account supply-side considerations[315] the result is the same. Although the costs of producing CFE are higher, it enjoys advantages that allow CFE generators to exercise a *competitive constraint* over other EGs. Indeed, CFE generators have the particular capacity of producing -through a carbon-free process[316]- base, intermediate or peak load energy due to its reliability and ability to scale production up and down[317] as compared to other RE sources. The latters have, on the contrary, low reliability due to temporal variability and uncertainty caused by deviations between forecasted generation and actual production[318], and location-specific nature of resources (*i.e.* large tracts of lands, rivers, etc.)[319]. This amounts to conclude that even if the generation costs of CFE are higher than the WEP it is capable of imposing competitive constraints to other type of EGs because of the output it can reach, the reliability of the technology and the carbon-free emissions.

46. In sum, both demand and supply-side factors lead to the conclusion that CFE is able to exercise a competitive constraint over other energy sources, meaning that they are included in the same

[309] EC. (1997), para. 8
[310] Case fact number 2; Clarification question number 105
[311] EC. (1997), para. 7
[312] ICTSD (2015), p. 1
[313] ABR, *EC-Large Civil Aircraft*, footnote 2468
[314] ABR, *Canada- Renewable Energy,* para. 5.170.
[315] ABR, *EC- Large Civil Aircraft,* para. 1121; ABR, *Canada- Renewable Energy,* paras. 5.170-5.172
[316] Clarification question number 115
[317] *Ibid*. 121
[318] IRENA (2015), p. 10
[319] *Ibid*; Clarification number 115

relevant market, the BEM. The appropriate benchmark therefore should be the WEP in Eriador since i) it arises from the BEM –which is the market of the good in question in the country of provision-, and ii) it is *market- determined*, since that price is set by a combination of LTC and MTC awarded through open competitive tendering processes, and SMT whose prices are set via the auction method[320].

(ii) *The LTPA provides more than adequate remuneration as compared to the WEP*

47. The LTPA confers a *"benefit"*[321] as CFE is purchased for "*more than adequate remuneration*" when compared to the prices in the BEM, in the terms of Art. 14(d) of the SCM.

48. The formula set in the LTPA to determine the price of CFE (C=M+X*Y) departs from the average price paid for a unit of electricity in the BEM (M) and subsequently increases the value by adding other components (X*Y). Thus, the price paid under the LTPA will always be significantly higher than the WEP, exceeding it by at least 10%[322]. Hence, the LTPA confers a "*benefit*" as it provides "*more than adequate remuneration*", since it provides a significantly higher price for the good in question than the one available in the market –the WEP- for the same product.

3.1.3. The LTPA is de jure specific within the meaning of Art. 2.1(a) of the SCM

49. The LTPA is subject to the provisions of Part III of the SCM[323] as the legislation pursuant to which the EEC operates explicitly limits access to the FITS to "*certain enterprises*" that generate CFE[324], making the LTPA a *de jure* specific subsidy.

3.2 The LTPA causes serious prejudice to the interests of Borduria within the terms of Arts. 5(c) and 6.3(a) of the SCM

50. The imports of electricity coming from Borduria into the BEM in Eriador were displaced and impeded as an effect of the implementation of the LTPA. Art. 6.3 of the SCM provides that "*serious prejudice in the sense of paragraph (c) of Art. 5 may arise in any case where (...) (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member".* The AB stated that this provision *"indicates the need to identify a 'subsidized product' that is 'like' the product the importation (...) of which is being*

[320] Case fact number 3
[321] Section 3.1.2
[322] Case fact number 11 and clarification question number 9
[323] Art. 1.2 of the SCM
[324] Case fact number 11 and clarification question number 21

displaced or impeded in a particular market"[325]. Moreover, it considered that "*displacement or impedance would arise where the counterfactual analysis shows that the sales of the complaining Member would have **declined less** or would have been higher in the absence of the challenged subsidy*" [326].

51. Electricity produced in Borduria and imported into Eriador is "*like"* CFE, and the market phenomena occurred in a 'the BEM in Eriador-. The term "*like product*" is defined in footnote 46 of the SCM to mean, "*a product which is identical, i.e. alike in all respects to the product under consideration [...]",* which suggests that physical identity is the point of departure to consider when assessing likeness[327]. Electricity –regardless the source of production- is identical in all respects. Indeed, as the ICTSD states, *"[e]lectricity as a product cannot be physically distinguished on the basis of the type of energy used to produce it*"[328]; accordingly, electricity produced in Borduria and CFE are *"like products".* On the other hand, the market phenomena occurred in a *particular market* as CFE and electricity produced in Borduria competes in the BEM in Eriador as explained in Section 3.1.2(i).

52. Regarding the occurrence of displacement and impedance, the market share of the two Bordurian EGs that sell their electricity to Eriador –BEC and EB- has declined precipitously since 2012 –the year in which the LTPA was awarded[329]- as five major contracts were not renewed[330]. Before its implementation, the market share of the aforementioned companies amounted to 50%; but in the next four years since the measure was put in place the share decreased by 27%, reaching 23%, taking into account that the market share of EB and BEC had remained the same for two years (2010-2011) before the awarding of the LTPA. Furthermore, the EEC stated in its Annual Reports of Operations that the non-renovation of the contractual arrangements with the Bordurian suppliers was the *"direct result of unexpectedly large size and costs"* of the LTPA[331].

53. The LTPA caused serious prejudice to the interests of Borduria as, in absence of the subsidy, the imports of electricity from Borduria would have remained equal, or would have declined less, since it was for the "*unexpected large size and costs"* of the LTPA that the five major contracts

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[325] ABR, *EC-Large Civil Aircraft,* para. 1118
[326] *Ibid.,* para. 1163 (Emphasis added)
[327] PR, *Indonesia- Autos,* para 14.172
[328] ICTSD (2015), p. 1
[329] Clarification question number 69
[330] Case fact number 13
[331] Case fact number 13

were not renewed by the EEC; which means that counterfactually, without the measure, the EEC would have renewed all or some of the contracts.

4. GATT Art. XX is not available to justify measures that breach the SCM

54. GATT Art. XX is not available to justify provisionally measures that are found to be inconsistent with the SCM. The AB considered that *"neither obligations nor rights may be automatically transposed from one part of the legal framework into another"*[332]. Rather, it suggested that in order to justify a breach of a treaty provision invoking GATT Art. XX exceptions, an objective link between such provision and the Marrakesh Agreement must be established *"through a thorough analysis of the relevant provisions on the basis of the customary rules of treaty interpretation and the circumstances under the dispute"*[333]. The AB also cautioned about the presence of silence amongst the agreements by asserting: "*omission must have some meaning*"[334].

55. Borduria underscores that the availability of exceptions of Art. XX of the GATT to other Covered Agreements requires proving a link between the provisions that are found in breach with WTO obligations and Art. XX. In other words, it is not a matter of establishing a link *in genere* between the SCM and the GATT, but rather if the SCM provision that has been violated by the measure has a sufficient nexus with Art. XX. Indeed, the Panel should find that Art. XX is not available to justify breaches of part III of the SCM since the absence of express language referring to GATT Art. XX is understood better when analysed in the light of last subparagraph of Art. 5, and Arts. 6.9 and 8 of the SCM. In those three provisions Borduria finds genuine *exceptions* to the subsidies disciplines and if the drafters of the SCM expressly anticipated situations regarding Agricultural products and even environmental issues, this must be interpreted that the general exceptions should not be available because the exceptions in the SCM –which are of a restrictive interpretation[335]- have been developed within the Agreement.

56. Second, if the Panel finds that GATT Art. XX exceptions are available to justify any of the measures at issue, Borduria underscores that nevertheless the measures are not justifiable since they do not comply with the *chapeau* of Art. XX of the GATT. The *chapeau* is the second substantive element that a respondent must prove in order to justify provisionally a measure under

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[332] ABR, *China-Rare Earths,* para. 5.57
[333] *Ibid*., Para 5.68
[334] ABR *Japan –Alcoholic Beverages* II, p. 18
[335] PR, *US- Underwear,* para. 7.21; PR, US- Shrimp, para. 7.46

the GATT Art. XX exceptions[336]. It also presupposes "*a heavier task than that involved in showing that an exception (...) encompasses the measure at issue"*[337]. Indeed, the respondent party has the burden of proving that the *application* of a measure does not result in *"arbitrary or unjustifiable discrimination between countries were the same conditions prevail".* The AB has insisted that "*One of the most important factors in the assessment of arbitrary or unjustifiable discrimination is the question of whether the discrimination can be reconciled with, or is rationally related to, the policy objective with respect to which the measure has been provisionally justified"*[338]. Borduria affirms that this standard is not met.

57. Eriador and Borduria are both concerned with the effects of climate change, as proven by the fact that both Members are parties to the FCPRE. Nevertheless, Borduria reminds that Art. 11 of the FCPRE obliges countries to ensure that at least half of its population energy needs are met by *"**RE suppliers**"*. Borduria maintains that the LTPA is a measure that results in discrimination since Bordurian suppliers are not able to obtain FFSS from any source in the world[339], rendering *de facto* a situation where electricity procurement discriminates foreign suppliers in favour of FE –a domestic producer-. This distinction cannot be reconciled with the policy objective pursued –the reduction of the negative effects of climate change by carbon emissions [340] - because a comprehensive program that included all RE EGs would result in a less discriminatory measure and still comply with that objective.

[336] ABR, *EC- Seal,* para. 5.169
[337] ABR, *US – Gasoline*, p. 21
[338] ABR, *Brazil – Retreaded Tyres*, paras. 227-228, and 232
[339] Clarification question number 89
[340] Clarification question number 103

Request for Findings- Conclusion

In light of the above, Borduria respectfully requests the Panel advise the DSB to:

9. *Find* that the IFFG is a *"subsidy"* inconsistent with Art. 3.1(a) of the SCM.
10. Alternatively, *find* that the IFFG is inconsistent with Art. 5(c) of the SCM as it causes serious prejudice to the interests of Borduria in the sense of Art. 6.3(c) of the SCM.
11. *Find* that the EL is a "*subsidy*" within the meaning of Art. 1.1 of the SCM.
12. *Find* that the EL is inconsistent with Art. 5(c) of the SCM as it causes serious prejudice to the interests of Borduria in the sense of Art. 6.3(c) of the SCM.
13. *Find* that the LTPA is "*subsidy*" as described by Art. 1.1 of the SCM since it confers a "*benefit*" to FE.
14. *Find* that the LTPA is in breach of Art. 5(c) as it causes serious prejudice in the sense of Art. 6.3(a) of the SCM Agreement.
15. *Recommend* that Eriador bring its measures into conformity with its obligations under those provisions.