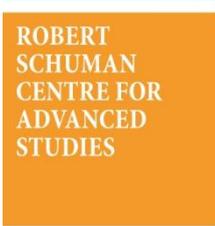




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What does the recent WTO litigation on renewable energy subsidies tell us about methodology in legal analysis? The good, the bad, and the ugly

Luca Rubini



European University Institute  
**Robert Schuman Centre for Advanced Studies**

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## **Abstract**

Through the use of the recent litigation on renewable energy subsidies in the World Trade Organization ('WTO') as case-study, this paper highlights the importance of methodology in legal analysis and, in particular, of integrity, coherence and legitimacy. Reference is made to those cases where, in presence of pressing policy considerations, the adjudicator is led to commit serious errors in order to reach what is perceived as a just and desirable outcome. It is sometimes the case that adjudicators are called to distinguish a 'good' policy from a 'bad' one, and, if the regulatory framework is not sufficiently responsive to such distinctions, the act of accommodation of law and policy may lead to 'ugly' constructions of the law. The twist of this course of conduct is that the effects of legal interpretation tweaking might not be easily confined to the case at hand and may have broader, negative implications for the legal system at large. Rather than resolving into a simple criticism of adjudicating bodies, the paper argues that the ultimate responsibility for dispute settlement mistakes caused by policy pressures is that of law-makers and their inability to take the lead and reform the law.

## **Keywords**

World Trade Organization – SCM Agreement - renewable energy subsidies – dispute settlement – legal interpretation



‘Facci dunque uno principe di vincere e mantenere lo stato: e mezzi saranno sempre iudicati onorevoli e da ciascuno lodati’ (Machiavelli, *Il Principe*, 1532, chapter XVIII).<sup>1</sup>

## 1. Subject of the paper\*

This paper is about methodology in legal analysis. It is in particular about the importance of integrity and coherence in legal methodology. In itself this is not a novel claim but neither is it a modest one.

Since legal analysis is often subject to corruption, it is certainly one that needs regular reinstatement. It is in particular known how policy considerations may affect legal interpretation. While in some cases the regulatory framework may, expressly or on a proper construction, allow for this, in other cases it is not that responsive. If, in such cases, the adjudicator still follows policy pointers too far, she or he will inevitably commit errors in the legal analysis. The paradox is that these errors are functional to (and hence considered justified by) what is perceived as a good policy, in a word a just, outcome for the case. In the eyes of the adjudicator they are good law since they lead to a just result. From another perspective, these errors are seen as the price to pay to achieve a desirable solution. In essence, what is at work here is the common Macchiavellian adage, whereby the end justifies the means. The twist is, however, that the effects of legal interpretation tweaking might not be easily confined to the case at hand. Whatever precedential value judicial decisions have in their legal system, the interpretations they carry may have repercussions on future cases. More generally, the interpretations coming out of the settlement of one dispute may have implications for the legal system at large.

It is in the light of these considerations that the claim that what matter in adjudication is to achieve a just outcome (assuming we know and agree on what it is) is considered, and balanced with another claim, that in legal analysis process and methodology matter, and are more important than outcome. At its core, therefore, this paper puts forward a normative claim, about how legal interpretation should (not) be performed, about its limits.

These themes are addressed through the use of a case-study coming from the recent WTO litigation on renewable energy subsidies.<sup>2</sup> The two disputes focusing on Ontario’s Feed-in Tariff Programme and its Local Content Requirements have attracted a lot of debate and analysis in academic and policy circles alike. The use of a real factual and litigation scenario can both engross and, at the same time, lighten the discussion. Furthermore, this debate is not only about what is appropriate or not appropriate in legal analysis. If it is concluded that the current regulatory framework, as it currently is, is not sufficient, this analysis may pave the way to law reform discussion.

Part 2 outlines the case, also setting out its background and the policy discourse surrounding it. In Part 3 we go through the subsidy analysis, and in particular the benefit test, and we review the main steps of the reasoning of Panel and Appellate Body. In doing so we identify a few egregious errors in the legal and economic analysis. After this review, we address two doubts – the first whether the

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<sup>1</sup> ‘Let thus a prince have the credit of conquering and holding his state, the means will always be considered honest, and praised by everybody’, translation of the author.

\* The author wishes to thank for comments on previous drafts, and conversation on the topic, Stefano Berdea, Aaron Cosbey, Claus Dieter Ehlermann, Bernard Hoekman, Petros Mavroidis, Jorge Piernas Lopez. Some initial ideas of this paper were presented at a CTEI workshop in Geneva (June 2013), at the DISSETTLE Workshop in Brussels (September 2013), at the second meeting of E-15 Clean Energy and the Trade System group in Geneva (October 2013) and at a seminar of the Global Governance Programme, European University Institute, Florence (December 2013). The author wishes to thank their participants for useful reaction and comments. The usual disclaimers apply.

<sup>2</sup> Canada – Certain Measures Affecting the Renewable Energy Generation Sector (DS412); Canada – Measures Relating to the Feed-In Tariff Program (DS426), hereinafter Canada – Renewable Energy/FIT disputes.

whole litigation could in fact be considered a pantomime, the second whether, all in all, it should be considered a good decision. Part 3 suggests how the case should have been decided and Part 4 presents its lessons for judicial methodology. Part 5 closes.

## 2. Introducing the case-study: the *Canada – Renewable Energy/FIT disputes*<sup>3</sup>

### **Background**

The case involved a feed-in tariff ('FIT') enacted by the Canadian Province of Ontario ('Ontario FIT Programme'). This is a scheme that pays guaranteed premium rates for set periods to electricity produced by renewable energy sources, in the instant case solar PV and wind. Typical FITs also guarantee access to the distribution grid on specified terms. To be eligible for the premium rates, the electricity generated had to come from equipment that had some minimum level of domestic content that varied from technology to technology (levels ranged from 25% for large wind projects to 60% for some solar PV). This condition is known as local content requirement ('LCR').

In the panoply of the policy measures used to mitigate climate change, FITs are a very common incentive scheme. They are used in more than 71 countries and 28 state/provinces worldwide.<sup>4</sup> Their aim is to ensure the rapid dissemination of renewable energy, and numerous studies indicate their effectiveness at achieving a rapid deployment of renewable energy generating capacity.<sup>5</sup> In turn, a good record in capacity deployment is a good proxy of the environmental effectiveness of the measure, although not necessarily of its cost-effectiveness.<sup>6</sup> Thus, in the light of both their objectives and results, FIT schemes are essentially an *environmental* measure.

The insertion of LCRs in climate change policy measures is common too.<sup>7</sup> LCR is a condition that can be attached to some benefit (such as FITs) as a threshold condition, and is not fundamentally an environmental measure. It is rather an instrument of *industrial policy* that seeks to build up backward linkages in the domestic economy. Of course it can also be argued that the LCR is ultimately an environmental measure, since it is the "grease" that makes possible the environmental measure to which it is attached. In a nutshell, the argument goes, without the promise of local jobs as a payback, it might be difficult to convince voters to back a plan that would see their power bills increasing. Especially in these times of fiscal restraint it is difficult to sell environmental measures on their own, without also arguing that they will have clear economic benefits.

The Ontario FIT Programme was launched in October 2009. It was the third initiative adopted by the Canadian Province since 2004 to increase the supply of electricity produced from renewable energy sources. Ontario, the most populous Canadian province, was the first in North America to implement a comprehensive FIT programme for renewable energy. Through this programme it aimed

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<sup>3</sup> For a shorter, preliminary commentary of the *Canada – Renewable Energy/FIT* case see Cosbey and Rubini, *Does it FIT? An Assessment of the Effectiveness of Renewable Energy Measures and of the Implications of the Canada – Renewable Energy/FIT disputes*, Geneva, ICTSD, E-15 Initiative, Clean Energy and Trade Group, October 2013. Few parts of this paper draw on this short think-piece.

<sup>4</sup> REN 21, *Renewables 2013 – Global Status Report*, Paris, 2013, p. 68.

<sup>5</sup> Lipp, 'Lessons for effective renewable electricity policy from Denmark, Germany and the United Kingdom' (2007) *Energy Policy*, p. 5481; Butler, Neuhoff, 'Comparison of feed-in tariff, quota and auction mechanisms to support wind power development' (2008) *Renewable Energy*, p. 1854; Fouquet and Johansson, 'European renewable energy policy at crossroads—Focus on electricity support mechanisms' (2008) *Energy Policy*, p. 4079; Deutsche Bank, *Global Energy Transfer Feed-in Tariffs for Developing Countries*, April 2010.

<sup>6</sup> For any given regime of FITs it can indeed be asked whether the objective of deployment could be achieved at a lower cost by other policy measures.

<sup>7</sup> Hufbauer, Schott, Cimino, Vieiro, Wada, *Local Content Requirements: A Global Problem*, Washington DC, Peterson Institute for International Economics, 2013.

to diversify its energy-supply mix, in particular by progressively phasing out coal-generated electricity and increasing the use of cleaner energy sources and technologies. Job-creation was also in the mind of Ontario's government. Through the LCR Ontario sought to build up in-province capacity in the manufacturing sector that supplied the wind and solar PV generating sector. The FIT Programme was successful in increasing capacity and attracting investment. Several large foreign companies were led to the province. South Korea's Samsung made the more high-profile deal, leading a consortium that, just few months after the entry into force of the programme, in January 2010, unveiled a CA\$7 billion (US\$6.8 billion) investment in the province.<sup>8</sup> According to the press, only fifteen months after the programme start, a total of 2,625 megawatts of FIT contracts had been signed, and many more projects were in the queue waiting for approval.<sup>9</sup> In terms of job creation, Ontario's target was of 50,000 green jobs, with 16,000 expected from Samsung's deal alone.<sup>10</sup>

From a trade perspective, the key question is whether policies like FITs and LCRs can distort trade.<sup>11</sup> In general supply-side policies such as FITs, when they do not favour domestic over foreign producers,<sup>12</sup> act to increase flows of trade and investment. They create new markets for goods and services from both domestic and foreign suppliers, and similarly encourage investment from both domestic and foreign sources. In short, if this is a distortion, it is a good one. What remains to be seen is whether, and under what circumstances, FITs could also cause negative externalities and affect cross-border trade in energy itself. Although LCRs almost always act as condition for the receipt of some benefit (they are in a sense 'part and parcel' of the policy package), taken in isolation, they are expressly aimed at distorting trade and investment flows and have clear and significant trade-distorting impact.<sup>13</sup> For this reason, they are expressly prohibited under WTO subsidy laws.

Against this background, it is interesting to note that challenges to energy subsidies (encompassing both fossil fuel and clean energy subsidies) have been laconically absent from the registers of WTO cases or national trade remedy investigations. This concerns both measures of support to energy production and to technology. This non-belligerence scenario can be largely explained with the low or even non-existent spillovers caused by these subsidies to the various trade, investment and political interests at stake, combined with the known 'glasshouse' effect. Everybody gives subsidies in support of energy. Nobody has an interest in raising a claim and risking a highly probable counter-claim. In other words, in what is certainly a simplified picture, the significant and spread subsidization in the energy sector has been tolerated until *new factors* came in and contributed to alter the equilibrium, in particular by making competitors' subsidization harmful, waking up lobbies and special interests, and thus forcing governments to react. In particular, renewable energy has increasingly become a key player in the energy market, in some cases almost reaching grid parity with conventional sources, and catalysing bigger economic, social and political interests. Often courtesy of public support, technology has developed extremely fast, prices have decreased dramatically, and market opportunities have blossomed. Against this scenario of increased relevance, governments' tolerance level for foreign subsidization has correspondingly decreased. Challenges have been initiated, in particular (but not exclusively) for the more obvious breaches of the rules of the game, which is through discriminatory elements like LCRs.<sup>14</sup>

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<sup>8</sup> Reuters, 'Japan starts WTO dispute with Canada on clean power', 13 September 2013.

<sup>9</sup> Oxtoby, 'Energy in FITs and starts', *The Globe and Mail*, 23 February 2011.

<sup>10</sup> Also as a consequence of the negative WTO ruling, many of these figures had to be scaled down. See Campbell, 'Ontario slashes Samsung deal following WTO ruling', *Windpower Monthly*, 24 June 2013.

<sup>11</sup> Bahar, Egeland and Steenblik, *Domestic Incentive Measures for Renewable Energy with Possible Trade Implications*, OECD Trade and Environment Working Papers 2013/01.

<sup>12</sup> A case of domestic preference is the purchase obligation of certain FIT schemes.

<sup>13</sup> See Bahar, Egeland and Steenblik, note n. 11 above.

<sup>14</sup> For a full review of these cases see Wu and Salzman, 'The Next Generation of Trade and Environment Disputes: The Rise of Green Industrial Policy', 108 *Northwestern University Law Review* (forthcoming 2014).

These few notes provide the general background of the challenge to the Ontario FIT Programme which, with Japan's launch of the WTO case in September 2010, can be considered as the start of the significant WTO and domestic litigation that has since involved several 'green energy' subsidies. It is, however, interesting to consider the more fact-specific circumstances underlying this challenge.

In September 2010, the news that Japan had filed a WTO claim for Ontario FIT Programme raised some eyebrows. Only few days after the lodging of the request for consultations, it was reported:

Other experts say they think it is puzzling that Japan has decided to make its move now. Ontario's neighbouring province Quebec has had a local-procurement program for years for its energy development, they note, including rules that force power producers to buy equipment from specific regions inside the province. The Quebec policy has never drawn complaints from the Japanese, the source says.

Some observers have speculated that Japan is targeting Ontario in the wake of a \$7 billion contract given to Korean competitor Samsung by the Ontario government. Recently, Japanese companies - such as Sharp, Mitsubishi, and Kyocera - were on the losing end of a US\$20 billion nuclear power deal in the United Arab Emirates. The Ontario deal could be perceived by Japan as a sign of losing ground in the green energy arena, some experts say.

Under the agreement with Samsung, Ontario will provide the company with subsidies to establish a massive solar and wind energy capacity in the province. The government will support the company by providing preferential grid access, financial assistance, and land. The deal has been a boon to Samsung, which is vying to position itself as a major renewable energy player. Samsung, as part of the deal, will also establish a wind turbine facility and solar power production facility in Ontario.

If Japan eventually wins its claim, it could be a blow for Ontario's alternative energy plans. The prices the province pays for green energy - for certain types of solar power it is almost 20 times the rate customers pay - can only be financially justified if Ontario gets significant employment benefits from new development.<sup>15</sup>

This vivid account tells a paradigmatic story of the current green economy, of the various stakes that are at issue, and of the frictions caused by public policy attempting to shape markets. It also exemplifies a scenario where the said 'glasshouse' effect does not constrain government's reaction anymore.

The EU and the US soon requested to join Japan in the consultations with Canada. Despite pressure from the domestic solar industry to act as co-complainant, the US did prefer to simply maintain a third-party status, worried of possible counter-challenges to its own support programmes.<sup>16</sup> As for the EU, reportedly after a failed attempt to reach a negotiated solution, it filed its own request for consultations on 11<sup>th</sup> August 2011. On various occasions, the EU highlighted as motives underlying its challenge both trade interests and systemic concerns as to the correct application of WTO law.<sup>17</sup> It emphasized its role as a 'significant' exporter to Canada of wind power and solar PV generation equipment, with exports ranging from €300 to €600 million in the 2007-2009 period, adding that 'these figures could be higher should the local content requirements be removed from the legislation in question'.<sup>18</sup>

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<sup>15</sup> ICTSD, 'Japan Challenges Canadian Renewable Energy Incentives at WTO', Bridges Weekly Trade News Digest, Volume 14, Number 31.

<sup>16</sup> 'USTR Cautious On Japan's WTO Challenge Of Canadian Green Energy Law', *Inside US Trade*, 23 June 2011.

<sup>17</sup> See EU Request to join consultations, WT/DS412/3, 29 September 2010.

<sup>18</sup> ICTSD, 'Major Green Disputes Move Ahead at WTO', Bridges Weekly Trade News Digest, Volume 15, Number 29.

## **Outline of the case**

### Claims

The disputes focus on the WTO-law consistency of the Ontario FIT programme. In particular, Japan and the EU complained with the WTO dispute settlement claiming that, by imposing the LCR on electricity generators using solar PV or wind power technology, the programme was incompatible with the prohibitions of

1. non-discrimination as laid down in the obligation of national treatment of Article III:4 the General Agreement on Tariffs and Trade ('GATT') and Article 2.1 of the Agreement on Trade-Related Investment Measures ('TRIMs'), and
2. local-content subsidies under Article 3 of Agreement on Subsidies and Countervailing Measures ('SCM Agreement').

It is worth highlighting that the focus of the two legal claims and the relevant analysis is partly different, with the first being concentrated on the legality of the LCR itself, and the latter on the classification of the FIT as a subsidy, as a necessary and preliminary condition of a finding of the existence of a measure illegally conditional on localization. This is a crucial difference, and we will come back to it at length.

A Panel and then the Appellate Body heard the case. The reports were respectively issued on 19 December 2012 and 6 May 2013 and were adopted on 23 May 2013.<sup>19</sup>

### Findings

Both Panel and Appellate Body easily concluded that the LCR element of Ontario's programme did breach the prohibition of non-discrimination.<sup>20</sup> This finding was not discredited by Canada's defence whereby the LCR could not be discriminatory because it was imposed as part of Ontario's purchasing of goods 'for governmental purposes' and not for commercial reasons. Article III:8(a) of the GATT reads that the prohibition of discrimination 'shall not apply to laws, regulations or requirements governing the procurement by governmental agencies of products purchased for governmental purposes and not with a view to commercial resale or with a view to use in the production of goods for commercial sale.'

As for the subsidy claim, a positive determination that the FIT was a subsidy was necessary to then conclude that the programme was prohibited because it included the LCR element. The WTO legal definition of subsidy is constituted of two parts. You need to have a form of 'financial contribution', in one of the examples provided under Article 1 of the SCM Agreement, or, alternatively, 'any form of income or price support'. In addition to this, the measure must confer a 'benefit'.

Both the Panel and the Appellate Body concluded that Ontario's FIT was a 'purchase of goods'. The focus then shifted to whether this purchase of goods could confer a 'benefit' – which is the crucial legal issue in the subsidy claim analysis and in this paper. This issue was so controversial that the Panel was split, with one member issuing a separate opinion. The details of this dissent are outlined and commented below. For the purposes of this brief summary, suffice reporting that the Panel could not determine, on the basis of the various benchmarks put forward by the complaining parties, that

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<sup>19</sup> On 20 June 2013, Canada informed the DSB that it intended to implement the decision and that it required a reasonable period of time to do so. Canada, Japan and the EU agreed that the reasonable period of time to implement the DSB's recommendations and rulings should have been 10 months, expiring on 24 March 2014.

<sup>20</sup> To do so, it was interestingly found that the mere participation in Ontario FIT Programme (of which the LCR was a necessary condition and prerequisite) did confer an 'advantage' on eligible generators.

Ontario's FIT confer a benefit. Although with a partly and significantly different reasoning, this conclusion was substantially confirmed by the Appellate Body.

#### NAFTA investment claim

The Ontario FIT Programme was challenged also in the North-American Free Trade Agreement ('NAFTA'). In July 2011, the US-based renewable energy company Mesa Power Group filed a complaint under Chapter 11 of the NAFTA, claiming that the Canadian programme violated NAFTA's investment provision. The claimant runs various wind farm projects in south-western Ontario. Mesa Power alleged that Canada failed to accord it fair treatment by changing the rules of award of certain wind contracts as well as those governing the territorial limits for interconnection, by imposing content requirements and 'buy local' performance requirements, by providing more favourable transmission treatment to Canadian companies and local subsidiaries of Samsung. All this was alleged to amount to a breach of Chapter 11 national treatment and MFN obligations. As a consequence of the substantial loss and damage allegedly caused, Mesa Power sought compensation for no less than CND\$775 million.<sup>21</sup>

#### *Policy narratives*

Two different policy narratives surrounded the case and one arguably influenced the legal outcome. In particular:

- *Policy narrative 1.* At one level there was the narrative of labour lobbies and green movements, also in unlikely transnational alliances, which unreservedly supported Ontario's programme, and criticized the legal challenge and the WTO possible intrusions with what they perceived as a good policy.<sup>22</sup> Crucially, this narrative does not distinguish between the two elements of the policy, i.e. the FIT and the LCR, and seem to look at them as a single measure, good to achieve the 'twin goals' of reducing greenhouse gas emissions and transitioning to a clean energy economy.<sup>23</sup> Post-Panel reports claims that WTO dispute settlement decisions are 'not binding' and Canada should 'ignore' them are a by-product of this narrative.<sup>24</sup>
- *Policy narrative 2.* Another narrative comes out from recurring statements of the complainants during the legal proceedings. This narrative crucially separates FITs, as good policy, and LCRs, as bad policy. It is the latter's discriminatory element – not the FIT - that troubled Japan and the EU (and many of the intervening third parties) and prompted the litigation. It is this element – not the FIT - that they wanted to have struck down.

A few comments can be made.

First, the local and international political debate mingles with these narratives. The Green Energy Act and the Samsung deal were clearly the focus of the local provincial election.<sup>25</sup> More interestingly, in an address of 30 April 2010, before any challenge had actually been initiated, Canada's Minister of

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<sup>21</sup> Mesa Power's Notice of Intent to Submit A Claim to Arbitration under Section B of Chapter 11 of the North American Free Trade Agreement, available at <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/mesa.aspx?lang=eng> (last access, 15 January 2014).

<sup>22</sup> See, eg, 'Environmental Groups Wary Of WTO Ruling On Canada Energy Program', Inside US Trade, 18 January 2013, mentions a letter signed by 12 US environmental, public interest and other groups urging US Trade Representative Ron Kirk to back off from the third-party participation of the US in the case.

<sup>23</sup> Ibid. See also Public Citizen and Sierra Club, 'Ontario's Feed-in Tariff: Will the WTO Trump Climate Imperatives?', June 2013.

<sup>24</sup> See CBS News, 'WTO Rules Ontario Green Energy Tariff Unfair', 19 November 2012, available at: <http://www.cbc.ca/news/business/wto-rules-ontario-green-energy-tariff-unfair-1.1185686> (last access, 15 January 2014).

<sup>25</sup> Howlett and D'Aliesio, 'How Samsung became an Ontario election flashpoint', *The Globe and Mail*, 29 September 2011.

Foreign Affairs and International Trade specifically cited the Ontario Government as a barrier to the bilateral negotiations with the EU.<sup>26</sup> There can be no doubt that the high-profile FIT Programme was in Mr Van Loan's mind.<sup>27</sup>

Secondly, the first narrative is not appropriate since it does not distinguish the different goals and effects of the two policies. The second narrative, with its approval of FITs and disapproval of LCRs, is partly in line with what happens and what is normally accepted in most countries, and what, admittedly, the law clearly says (although litigation is often necessary to reinstate the common rules of the game, and realign law and practice.)

Finally, the legal discussion and the outcome of the case closely reflect the policy distinction of the second narrative. The national treatment route is explored up to its very end, and with a rigorous prohibition of the LCR. As we are about to see, once this goal is achieved, the subsidy route is pursued only in so far as it is necessary to determine that there is not enough evidence to conclude that the FIT is a subsidy. In other words, the bad, discriminatory element is expunged with surgical precision, leaving the tissue of the FIT ultimately intact.

### **3. Law, economics, policy: a matter of methodology**

Law is about giving sense to rules – by interpreting them. And, although it is widely accepted that interpretation is an 'act of construction of meaning',<sup>28</sup> this does not imply that the interpreter (essentially the judge) is completely free in this process. The general claim of this paper is that methodology in legal analysis matters. This more specifically becomes a claim of integrity and coherence in legal reasoning. Furthermore, since when dealing with economic facts, legal analysis often needs to interact with economic analysis and expertise, it then becomes crucial to understand the respective roles of law and economics, and who (the lawyer or the economist) should perform the analysis and how this should be done. Finally, in the context of trade law, the interpretation of rules in judicial proceedings is functional to their application to specific measures that are the expression of given policy choices made by sovereign actors. This means that the anticipation and apprehension of certain policy outcomes may have an impact on legal interpretation. As this paper attempts to show, this influence is negative when it clashes with few basic methodological requirements.

As the reader may have guessed by now, the discussion here does not relate to domestic common law systems. These are based on judicial-law making process and, as such, the judge-interpreter enjoys a significant degree of freedom in constructing the law. Our claim and analysis focus on the interpretation of international treaties and rules that puts the judge-interpreter in a position closer to the domestic counterpart (in common and civil law systems alike) when interpreting domestic statutes or constitutions. The main difference is that in both cases the judge-interpreter has to work on rules that have been created by a legislator or trade negotiator, and cannot create them from scratch.<sup>29</sup>

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<sup>26</sup> 'Opening Markets Across the Atlantic: The Next Step in Canadian Free Trade', Address by Minister Van Loan to Economic Club of Canada, Toronto, 30 April 2010.

<sup>27</sup> It should be recalled that the measure at issue is not a federal but a provincial one, for which, however, the government of Canada was responsible at the international plane.

<sup>28</sup> Borrowing from a classic account of legal interpretation in the European Union, whose insights certainly go beyond the European *milieu*, legal interpretation is not 'simply a reading of the text to see what it says, and following through the assumption that it means what it says'. Bengoetxea, MacCormick and Soriano, 'Integration and Integrity and Legal Reasoning of the European Court of Justice', in De Burca and Weiler (eds), *The European Court of Justice*, Oxford, Oxford University Press, 2001, p. 43, at p. 44.

<sup>29</sup> Although, certainly, depending on the context, the degree of freedom enjoyed by the judge may vary whether she or he has to deal with a statute or a constitutional text. This variance does not, however, detract from the point we make, and wish to highlight again. There is a fundamental difference between those scenarios where the interpreter is officially considered as a law creator and those where he acts as a, more or less free, but still as an interpreter.

### *Momentous steps, egregious errors*

In this section we review the major steps in the legal reasoning of the *Canada – Renewable Energy/FIT* disputes. In the process, we outline a few egregious errors of methodology committed by the Panel and Appellate Body.

#### a. The first legal weakness: the Panel majority's compassion

The key argument of the Panel majority was that it was not possible to talk, or even think, of a competitive energy market in Ontario (and perhaps even elsewhere). Consequently, the various benchmarks put forward by Japan and the EU, all substantially relating to Ontario's wholesale electricity market, could not be appropriate.<sup>30</sup> Similarly, the benchmarks based on what happened in other Canadian Provinces or neighbouring US regions were not considered appropriate.<sup>31</sup>

Let's try to reconstruct this argument. The starting point is the recognition of Ontario's choice of energy supply-mix (more clean energy, based on renewable sources, less conventional, especially coal-based, energy). This choice depended on reliability of supply as well as environmental and human health considerations. The Panel majority then noted that *no* competitive market would, *even hypothetically*, attract the *type* of supply of energy the Canadian province sought. In other words, we are confronted with a 'public good' scenario, where the desired goods (ie renewable energy) are under-provided in the absence of government intervention. Indeed, in the case at hand, all this was common ground. Even the defendant conceded it:

Canada accepts that 'most; of the contested FIT generators would be unable to conduct viable operations in a competitive wholesale market for electricity in Ontario. Indeed, Canada points out that one of the objectives of the FIT Programme was to encourage the construction of new renewable energy generation facilities that would not have otherwise existed.'<sup>32</sup>

So far, so good. The change of gear in the reasoning of the Panel majority happens when they move from i) the inability of the market to achieve the desired public policy goals (which may in principle justify public action in the form of subsidization) to ii) the impossibility to use the market as baseline for determining the existence of a benefit and hence a subsidy (a determination which simply enquires the effects of public intervention but does not negate its need or justification). In other words, the Panel's majority approach confuses the two separate issues of the *existence* of a subsidy with its economic and policy *justification*, and conflates both within the context of what can be considered a preliminary step in the legal analysis, ie the definition of subsidy.

This 'merger and acquisition' of different considerations within the benefit analysis can be appreciated in the following quote:

the complainants have not convinced us of the premise underlying their two main lines of benefit arguments, namely, that in the absence of the FIT Programme, the FIT generators would be faced with having to operate in a competitive wholesale electricity market. The evidence before us indicates that competitive wholesale electricity markets, although a theoretical possibility, will 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.<sup>33</sup>

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<sup>30</sup> Panel Report, para. 7.308.

<sup>31</sup> Ibid; see also paras. 7.303-7.307.

<sup>32</sup> Panel report, paras. 7.277.

<sup>33</sup> Panel, paras. 7.309, emphasis in the original.

The first statement is plainly wrong: but for government intervention, FIT generators would by necessity 'be faced with having to operate in a competitive wholesale electricity market'. They might conclude that this is not a profitable scenario and decide not to produce, but that's another story. Their counterfactual world would be a competitive one and, at the same time, one where the market fails to provide the desired public goods. But the two aspects are different and should thus be kept separate.

In sum, the 'compassion' of the Panel majority for the policy rationale underpinning Ontario FIT Programme is clear and raises fundamental issues of methodology in legal analysis. Compassion, that is the ability to appreciate and participate others' feelings (that our Greek ancestors called 'sympatheia'), is generally a virtue, but not necessarily in legal adjudication. Good, legitimate policy goals need to be positively recognized in the rules (by the legislator), not forced through the normative fabric of rules (by the adjudicator). The bottom-line is that WTO tribunals are courts of law, not equity.

b. The dissenter's call to integrity

While the Panel's majority approach *conflated* the two separate issues of the *existence* of a subsidy with its economic and policy *justification*, the dissenting panellist seemed to have been more sensitive to the need, and possibility, to keep market and policy considerations separate. The benefit should be determined only on the basis of the former, keeping the latter aside.

In particular, while disagreeing with the majority, the dissenting panellist essentially opined that an appropriate benchmark could be found, even in a hypothetical competitive market, in the wholesale market that 'could' exist Ontario.<sup>34</sup> Furthermore, he suggested that, even without embarking on the quest for a precise market benchmark, the fact itself that the FIT is there to 'facilitate' the development of certain technologies is indicative of the existence of a benefit.<sup>35</sup>

In various passages, he clearly stated this separation between subsidy existence and its justification:

The Panel majority concluded that the wholesale electricity market currently operating in Ontario cannot be used for the purpose of conducting the benefit analysis. In addition, the Panel majority found that the competitive wholesale electricity market that could, in theory, exist in Ontario could also not be used as a basis for the benefit analysis because, in the light of the prevailing conditions of supply and demand, such a market would fail to attract the generation capacity needed to secure a reliable supply of electricity for the people of Ontario [footnote omitted]. In my view, however, the fact that a competitive market might not exist in the absence of government intervention or that it may not achieve all of the objectives that a government would like it to achieve, does not mean it cannot be used for the purpose of conducting a benefit analysis. Indeed, it is because competitive markets do not often work the way that governments would like them to that governments will decide to influence market outcomes by, for example, becoming a market participant, regulating market participants or providing them with incentives (or creating disincentives) to behave in a particular way. A government might also choose to intervene in competitive market outcomes by granting subsidies, as defined in Article 1.1 of the SCM Agreement. Provided that such subsidies are not prohibited under Article 3 of the SCM Agreement, a government will be entitled to maintain such measures, subject to the remedies available to other WTO Members under Parts III and V of the SCM Agreement where either "adverse effects" or "material injury" is proven.

The Panel majority has come to a number of conclusions about the shortcomings of competitive wholesale electricity markets and the inability of the market to achieve the legitimate objectives of the

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<sup>34</sup> While conceding that the 'wholesale electricity market in Ontario does not allow for the discovery of a single market-clearing price established through the unconstrained forces of supply and demand', he noted that the 'competitive wholesale market for electricity that *could* exist in Ontario is the appropriate focus of the benefit analysis'. Panel report, paragraph 9.3, emphasis in the original.

<sup>35</sup> Ibid.

Government of Ontario for its electricity system. However the fact that a market is imperfect in its operation or does not meet the objectives that a government might have for the goods or services which are traded in it does not shield financial contributions which take place in the market from the benefit analysis that is required under the SCM Agreement. In this regard, it is important to recall that the Appellate Body has consistently identified the "marketplace" as the relevant focus of a benefit analysis, regardless of its particular characteristics or imperfections:

The terms of a financial transaction must be assessed against the terms that would result from unconstrained exchange in the relevant market. The relevant market may be more or less developed; it may be made up of many or few participants. ... In some instances, the market may be more rudimentary. In other instances, it may be difficult to establish the relevant market and its results. But these informational constraints do not alter the basic framework from which the analysis should proceed. ... There is but one standard—the market standard ... [Appellate Body Report, *Japan – DRAMs (Korea)*, para. 172.]

This sensitivity to the need, and possibility, to keep market and policy considerations separate, and determine whether Ontario FIT programme could confer a benefit only on the basis of the former is again a choice of methodology. It can be contrasted to the Panel majority's 'compassion'. It is, in our view, a call to integrity in legal analysis.

### c. First economic misconception

The Panel majority did not simply reject the benchmarks put forward by the complainants. They also came out with their own benchmark.

The universe of reference is the market that currently exists in Ontario (and not a competitive market that, as seen, would fail the pursued policy objectives). The 'commercial nature of the FIT' should thus be evaluated against the 'actions of private purchasers of electricity in a wholesale market where the conditions of supply and demand mirror those that currently exist in Ontario ... against the types of arm's length transactions that would exist in a wholesale electricity market whose broad parameters are defined by the Government of Ontario.'<sup>36</sup> More specifically, the terms and conditions of the FIT should be compared 'with the terms and conditions that would be offered by commercial distributors of electricity acting under a government-imposed obligation to acquire electricity from generators operating solar PV and windpower plants on a comparable scale to those functioning under the FIT Programme'.<sup>37</sup>

This scene-setting paves the way to the test:

we are of the view that one approach to determining whether the challenged measures confer a benefit could be to compare the rate of return obtained by the FIT generators under the terms and conditions of the FIT ... with the average cost of capital in Canada for projects having a comparable risk profile in the same period.<sup>38</sup>

This test, which, in the Panel majority's view, should offer an 'immediate and clear' determination, looks wrong – fundamentally wrong - from an economic perspective. The risk profile of a comparable investment cannot be pertinent when, by definition, risk is not an issue in measures such as FITs that involve long-term (20 or 40 years) contracts. Moreover, this test is not particularly useful in practice. It is not clear how we might quantify the risk profile of this or any other sector, much less find sectors with similar risk profiles and derive the undistorted cost of capital faced by that sector.

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<sup>36</sup> Panel Report, para 7.322.

<sup>37</sup> Ibid.

<sup>38</sup> Panel, Report, para. 7.323.

This ‘immediate and clear’ test, expression of the ‘simple standard’ whereby rational distributors aim to minimize their costs and maximize their returns (sic!),<sup>39</sup> is the first economic misconception of the case. How could the Panel majority incur in such a gross misconception? It is again a matter of methodology. This test was not discussed at all during the litigation. No complainant put it forward. Nor did any economist (even participating as expert witness) endorse it. Where does it come from then? What is the mistake the Panel majority incurred here? In lawyers playing economics.

d. A friendly (but unwanted) help

At this stage it may be useful to note that the Panel and the Appellate Body were not alone with the parties in scrutinizing Ontario FIT Programme. Various *amici curiae* did submit briefs at both levels of adjudication.

The status of briefs submitted to the Panel and the Appellate Body by non-parties (so-called *amici curiae*) is still controversial and, absent an express legal basis,<sup>40</sup> unclear. Consequently, the role they play is limited. At the time of writing, the Appellate Body has not considered it useful to consider *amicus curiae* briefs in any case. The record is better, but only slightly, for Panel’s proceedings. Despite this extremely limited impact, it is, however, still common for Panels and the Appellate Body to receive ‘unsolicited’ briefs from individuals, companies and organizations. This happened in the *Canada – Renewable Energy/FIT* case too. The Panel received two briefs from various organizations,<sup>41</sup> while two further briefs ‘by an energy company and an academic’ were submitted to the Appellate Body. Interestingly, the energy company that submitted the first brief is Mesa Power, the company that had started litigation against Canada in the NAFTA. The ‘academic’ is this paper’s author.

We do not touch here on the legal and political issue of whether Panels and Appellate Body should make more use of information coming from outside the WTO citadel. As Mavroidis early noted, this might just be one of those cases of ‘much ado about nothing’.<sup>42</sup> In a nutshell, the question whether WTO dispute settlement organs (perhaps any adjudication body) may seek or in any case make use of information not coming from the parties can simply be solved within the contours of the principles of due process which, irrespective of any textual hook, should apply anyway.<sup>43</sup>

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<sup>39</sup> Ibid.

<sup>40</sup> Arguments in favour of the authority to accept and consider written briefs submitted by *amici curiae* have been drawn mainly from Article 13 of the Understanding on Rules and Procedures Governing the Settlement of Disputes, ‘DSU’ (which gives Panels the right to seek information), Article 16 of the Working Procedures of the Appellate Body (which gives the latter the general power to adopt appropriate procedures for the purpose of the appeal), and Article 17.9 of the DSU (which confers on the Appellate Body a broad authority to adopt procedural rules).

<sup>41</sup> The first was submitted by Blue Green Canada; the Canadian Auto Workers (‘CAW’); the Communications, Energy and Paperworkers Union of Canada (‘CEP’); the Canadian Federation of Students (‘CFS’); the Council of Canadians; the Canadian Union of Public Employees (‘CUPE’); and the Ontario Public Service Employees Union (‘OPSEU’). The second was lodged by the following organizations: the International Institute for Sustainable Development (‘IISD’); the Canadian Environmental Law Association (‘CELA’); and Ecojustice Canada.

<sup>42</sup> Mavroidis, ‘Amicus curiae briefs before the WTO: Much ado about nothing’, NYU Jean Monnet Working Paper, 2/2001. On amicus curiae briefs in the WTO see also Howse, ‘The Most Dangerous Branch? The Scope And Limits Of Judicial Power In The WTO’, in Cottier and Mavroidis (eds), *The Role Of The Judge In International Trade Law*, Ann Arbor, Michigan, University of Michigan Press: 2001, p. 111.

<sup>43</sup> The utility of amicus curiae briefs is their ability to broaden the court’s perspective. If the parties’ prerogatives to react to information and arguments presented safeguarded, the guiding principle for Panels or the Appellate Body in deciding whether to accept and make use of *amicus curiae* briefs should be the same that guides the US Supreme Court: “An *amicus curiae* brief that brings to the attention of the Court relevant matter not already brought to its attention by the parties may be of considerable help to the Court. An *amicus curiae* brief that does not serve this purpose burdens the Court, and its filing is not favored” (Rule 37 of the Supreme Court of the United States).

That being said, it is interesting to note that the briefs submitted in the *Canada – Renewable Energy/FIT* cases do touch on virtually all the issues raised in the two claims, from the classification of Ontario FIT Programme as financial contribution or form of price support, to whether a benefit is conferred, up to the various requirements of the public procurement exception. Sometimes they even go beyond what was actually argued, extending for example to discuss the thorny issue of the applicability of GATT Article XX to subsidies, in a move which is quite telling about what was expected in terms of legal outcome from the case.<sup>44</sup>

As can be expected, the tone of the argumentation varies depending on the author and the objective of the brief. Lawyers tend to be more prone to technical jargon and distinctions. Pressure and advocacy groups tend to make their policy point more generally. Also in terms of narratives, we can see some variance. NGOs, trade associations, trade unions and students associations briefs – all in support of Canada’s position – are generally espousing the first narrative outlined above: ‘Ontario’s programme is good for the environment and for jobs. WTO law cannot, should not, stand in the way of these legitimate goals.’

Be that as it may, as usual, neither the Panel nor the Appellate Body did want a friendly help. They stated that they did not repute it useful to consider the *amicus curiae* briefs submitted to them. It is, however, difficult to believe that this denial of interest should mean that the briefs were *all and simply* binned and that the two judicial bodies did not react in one way or the other to the arguments of the *amici*. Less so that they all were simply replicating the argument of the parties and did not bring any ‘relevant matter’ to the attention of the adjudicating bodies. If this is the case, transparency (leaving aside intellectual honesty) would have been better served by an explicit recognition of the role (even if minimal) these submissions played in the deliberation and reasoning. And it cannot be understood how this transparency could have prejudiced the parties’ prerogatives (especially if due process requirements in the presentation and contestation of the information of the *amici* briefs were fully adhered to). All this indifference and denial may, again, account as an error of method.

#### e. Second economic-legal misconception

The Appellate Body introduced two important innovations with respect to the analysis of the benefit that may well have important implications for the legality of future policies in the area of clean energy (and perhaps even beyond).

The first innovation lies in the finding that the first analytical step of the benefit analysis is the definition of the relevant market. It is only when the product market is defined in this way that the benchmark to be actually used in the benefit analysis can be identified. It is known that in antitrust law the definition of the relevant market is the first and most important operation of the analysis that leads to establish whether the companies under investigation enjoy market power. Within this context, the goal of defining the market is to enquire whether the products or services at issue are substitutable with each other, and hence to ultimately determine whether the firm investigated does face any competitive constraint.

The Appellate Body’s breakthrough is the full transplant of this antitrust-type analysis at the level of the definition, and in particular when it comes to establish whether the financial contribution at issue procures benefits to its recipients.

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<sup>44</sup> The pleading that the Panel should not have made any finding obstructing the applicability of the ‘general exceptions’ defence of GATT Article XX (which may offer shelter to environmental measures and whose applicability beyond the GATT to subsidies has recently been highly debated) is a good indication of the expectations of the WTO challenge to Ontario FIT Programme. In short, it was highly anticipated that the Panel (and the Appellate Body) would have concluded that the FIT was a subsidy.

The preliminary question we have to ask is the following. Is the definition of the relevant market, which encompasses both demand- and supply-side angles, something that should be done in the benefit analysis?

Market analysis such as the one carried out by the Appellate Body was never used in benefit determinations before. This can probably be explained with the fact that the identification of the appropriate market benchmark was in the main clear. As noted, the definition of the relevant market is traditionally done to determine what are the competitive constraints of firms and this is preliminary to the determination of whether there is market power. This type of analysis is done in subsidy laws but only at a subsequent stage, when it is necessary to establish whether the subsidy has caused a serious prejudice – which makes its use comparable to what is done in antitrust.<sup>45</sup> By contrast, the focus of the benefit is different, and simpler. It is to determine whether the company or sector at issue has received an advantage from the measure and not to conclusively establish that the measure has distorted trade and competition.

In other words, if the focus of the benefit analysis is simply to know if the financial contribution (or indeed the form of income or price support) procures benefits to specific recipients, there is really no need to consider, for example, supply-side considerations and dynamics (at least, at this time of the analysis). Ultimately, what we need to know at this stage is only the identity of those who received the preferential treatment and not of those that could have received it. The dynamics at the supply-side level may come into play but only afterwards when it is necessary to establish whether the subsidy has caused harm to competitors. In sum, by requiring a fully-fledged market definition, the Appellate Body is not asking the right question which is ‘do we have a benefit for these companies?’ and not ‘has this benefit and subsidy caused an anti-competitive harm?’

What is the problem with this approach? Antitrust people know that the definition of markets is a sensitive step. It fully determines the next steps of the analysis and the outcome of antitrust cases. It is also an uncertain, and hence pliable, exercise.<sup>46</sup> These considerations fully apply here too. To require a full market definition, and in particular the reference also to supply-side considerations, implies that a *narrower* definition of the market may eventually emerge. This may crucially mean that the conclusion that the financial contribution has conferred a benefit becomes *less* likely.

In this regard, it is interesting to note how market definition can produce different, indeed opposite results, depending on the context where the exercise is performed.

As noted, in the context of the determination of the benefit, the narrower the market (ie the more specific the reference group and the benchmark, and the more tailored to the characteristics of the alleged recipients), the less likely we are to conclude that there is an advantage. By contrast, in the context of antitrust injury (and, we can assume, the same can be affirmed for serious prejudice and injury subsidy claims), the narrower the market, the more likely the company can be found to have market power and hence harm competitors. We have different risks to watch out in the two scenarios: under-inclusion in the former, over-inclusion in the latter. Whether either risks is acceptable or not does depend on the assessment a given system makes of the consequences of the relevant determinations in terms of rule application (or lack of it).

To a large extent, we would argue, the performance of the market analysis in the context of the benefit is more sensitive. While a positive determination (for example because the benefit has been established only on the basis of demand factors, with the exclusion of supply ones) is not usually the end of the story (to conclude that a measure is a subsidy is in principle only the first step of the

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<sup>45</sup> This analysis is not carried out when we are dealing with export or local-content subsidies that are simply prohibited, without any need to show actual negative spillovers.

<sup>46</sup> Farrell and Shapiro, ‘Antitrust Evaluation of Horizontal Mergers: An Economic Alternative to Market Definition’, *The B.E. Journal of Theoretical Economics*, March 2010, available at: <http://www.bepress.com/bejte/vol10/iss1/art9> (last access, 15 January 2014). See also Kaplow, ‘Why (Ever) Define Markets?’ (2010) *Harvard Law Review* 437.

analysis),<sup>47</sup> a no-benefit determination would immediately put the measure beyond the scrutiny of subsidy laws, with significant repercussions in terms of transparency and subsidy governance. In a word, if no benefit is found to exist, there is no subsidy to notify. This means that other Members would have less opportunity to scrutinize the measure.

In conclusion, by introducing a supply-side analysis at the stage of the benefit determination, the Appellate Body has incurred in two fundamental methodological errors, one economic and one legal. The too quick and easy importation of an economic tool that is normally used in other contexts is the result of a misconstruction of both i) the goal of market definition and of i) the goal of benefit analysis (within the subsidy determination).

As we are about to see, these misconceptions paved the way to the narrowing of the market in the case at hand and, via this, to the second innovation of the Appellate Body: the idea that we can think of scenarios where governments artificially create markets and crucially shelter them from subsidy scrutiny. Whether these two steps were warranted or not is the subject of the next two sections.

#### f. Third economic misconception

Assuming now that the definition of the relevant product market is warranted at the level of the definition of subsidy, has the Appellate Body done it correctly?

According to the Appellate Body, in the case at hand, energy markets need to be looked at from both the demand side and the supply side. While the former, substantially based on what consumers do, would have pointed to one single energy market (irrespective of the source of generation),<sup>48</sup> the Appellate Body engaged in supply-side analysis to eventually narrow the market down to renewable energy (and in particular wind and solar) only.

In particular, the factor that led the Appellate Body to conclude for the existence of a separate market was the extremely high upfront costs of renewable energy generating capacity (partially offset by low operating costs) and the intermittency of renewable energy production, both of which contribute to the inability of wind and solar PV producers to compete unaided with conventional electricity producers. Assuming supply-side considerations are relevant when defining relevant markets, the factors relied on by the Appellate Body – costs of production of renewable energy – are not relevant to show substitutability or lack of it. They show the cost of production, not the cost of shifting production. This is economically ill informed. This is a precedent that will come back to haunt us outside of the realm of clean energy.

This is the third economic misconception, the one that, by determining that the market is particularly narrow, prepares for the next finding of the Appellate Body that expressly protects FITs from subsidy scrutiny. Arguably, the key step of the reasoning is not just the narrowing of the definition of the market, but its shrinking so that the reference group is essentially adjusted and tailored to the specific circumstances of the recipients of the measure. As a result, the conditions of the actual measures under investigation become close to the benchmarks available in *that* reference group, so close that it becomes difficult to conclude that the Ontario FIT Programme is an exception or deviation from the norm. Indeed, the scheme *becomes* the norm.

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<sup>47</sup> In other words, WTO subsidy disciplines do not object to subsidies per se, unless negative effects on cross-border trade can be established. Crucially, however, the determination that Ontario's FIT was a subsidy *would* have been 'game over' in the *Canada – Renewable/FIT* cases. As note 45 above explains, the inclusion of a local-content requirement in Ontario's FIT Programme would have at once led its simple prohibition.

<sup>48</sup> From the case file it was clear that the 'electricity is electricity' statement was true, and was not qualified by consumer preferences or indeed the practical possibility of empowering consumers with a choice on which electricity to be supplied with depending on its source.

g. When courts play God: the judicial creation of markets

The second innovation of the Appellate Body's benefit analysis is the introduction of the concept of governmental market creation and its distinction from government interventions in already existing markets. In particular, the Appellate Body noted:

a distinction should be drawn between ... government interventions that create markets that would otherwise not exist and ... other types of government interventions in support of certain players in markets that already exist, or to correct market distortions therein. ... While the creation of markets ... does not *in and of itself* give rise to subsidies within the meaning of the SCM Agreement, government interventions in existing markets may amount to subsidies.<sup>49</sup>

This is probably the most important statement of the Appellate Body's report, the culmination of its reasoning fully prepared by first requiring the definition of the relevant market and then narrowing it down to renewable energy only. It is the watershed that lays down the new line on what can be done without triggering the application of subsidy rules. As was soon noted after the report was made public, the Appellate Body is in effect providing a shelter for the support to clean energy, although its boundaries are not fully clear yet.

If we focus on the wording of this statement only, and we leave aside for a moment the issue of the correctness of the concession of more flexibility, we cannot but express our reservations.

The language is broad, vague and open-ended. It is by nature more conceptual than prescriptive, which is a danger in legal reasoning. Judgments need to clarify the law that has to be applied, and not conceptualize it and, through this, make it *less* clear. This language does not provide clear indications on how to practically determine what is covered and what is not covered, when we have a benefit and when we do not have it. Most importantly, the side-effects of a too much sweeping language may be felt in the future. The inherent vagueness of the Appellate Body's language opens the door for dangerous analogic reasoning in cases to come, and not necessarily in the clean energy sector only.

Now, has the Appellate Body managed to descend this conceptual level to provide more operative indications?

By looking at other parts of the ruling, it looks like it wanted to indicate that the 'creation of the market' scenario does include energy supply-mix decisions.<sup>50</sup> Now, crucially, the definition of the supply-mix would cover the regulation of the quantity and type of electricity supplied through the network and the timing of supply, in order to ensure constant and reliable supply,<sup>51</sup> or more generally the parameters of the system, but may also include price-setting, such as FITs (whose remuneration encompasses cost recovery and a reasonable margin) and quantity mandates.<sup>52</sup> Once the market has been created, benefit benchmarks should be found in the resulting 'competitive' markets.<sup>53</sup> In this respect, the attribution of more than adequate remuneration would appear to go beyond the 'market creation' scenario and constitute an intervention in an already existing competitive market.<sup>54</sup> The Appellate Body then attempted to complete the analysis on the basis of the factual evidence on file and seemed to indicate that, at least for wind, appropriate benchmarks could have been represented by RES initiatives where the remuneration was fixed through competitive bidding.<sup>55</sup> Eventually, it did not

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<sup>49</sup> Appellate Body Report, para. 5.188 (emphasis in the original).

<sup>50</sup> In particular, a common statement is that the definition of the energy supply mix does not *in and of itself* constitute a subsidy. See Appellate Body Report, paras. 5.175, 5.190, 5.227.

<sup>51</sup> Appellate Body Report, para. 5.185.

<sup>52</sup> Appellate Body Report, para. 5.175.

<sup>53</sup> Appellate Body Report, paras. 5.190, 5.219.

<sup>54</sup> Appellate Body Report, para. 5.228.

<sup>55</sup> Appellate Body Report, paras. 5.240-5.244.

make any finding due to the ‘complexity of the issues’ and ‘absence of full exploration’ (sic!) before the Panel.<sup>56</sup>

To be sure, if one wants to make the notion of ‘creation of the market’ operational, a lot of questions about the precise boundaries of this safe-harbour are left unanswered in the report.

For example, the Appellate Body is suggesting that the dividing line for FITs is whether the remuneration is adequate or not. But the key legal issue is that the criteria to determine this adequate level are still vague. What costs are we talking about? Any level? Is in particular the Appellate Body providing shelter for the compensation of *all* costs of renewable energy production? If so, is this footing of the bill correct? Or, rather, should the safe-harbour be given only to the extra or additional costs for producing clean energy? If this distinction is in principle sound, can it be made operational? What is the reasonable profit the Appellate Body is referring to? What does adequate remuneration mean? Further: Is the fact that remuneration is set through ‘competitive bidding’ really sufficient, when the said competitive bidding process ‘sets prices for delivered electricity at the levels of the lowest bids *meeting specified conditions*’.<sup>57</sup> What do these conditions pertain to? Can policy considerations go into them, and thus alter the commercial nature of the auction? In sum, how economically reliable are the signals coming out of this bidding process?

We finally come to the question of whether this legal conferral of flexibility is in itself correct. To be sure, what the Appellate Body is doing here is not simply acknowledging that governments may create the markets, but it is more radically making the most significant act of legal creation, by introducing a very important and potentially significant shelter.

Looking at it from another perspective, the idea that governments sometimes create markets does make some economic sense, especially when it is used loosely to refer to governments stepping in in the market and providing public goods that the market would under-supply. What leaves economists at a loss is when you point out to them that the Appellate Body hastened to add that this ‘market creation’ scenario should be contrasted with that of government interventions in already existing markets. This distinction is difficult to capture from an economic perspective, and not by chance. It is always about market failure scenarios that may justify public action. It is in fact purely a legal fiction, an act of judicial creation, functional to creating a carve-out and offering governments flexibility of action.<sup>58</sup>

Through the general and powerful language of the *genesis* of the markets, and the findings referring to the adequacy of the level of remuneration which make it partly operational, the Appellate Body is in effect creating a shelter for some, significant measures of support to renewable energy. The significance of this shelter can be properly appreciated if the Appellate Body’s approach is contrasted with that of the dissenting panellist. Its spirit, by calling a subsidy a subsidy, without for this reason demoting the legitimate public policy reasons underpinning it, is probably more attuned to economic

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<sup>56</sup> One is left to wonder whether, after two levels of adjudication, and after a great wealth of economic evidence and arguments put forward by the parties, this could really be so difficult.

<sup>57</sup> Panel Report, para. 7.29 (emphasis added).

<sup>58</sup> This could be the right moment to underline a paradox coming out from the Appellate Body’s finding. The ‘market creation vs market intervention’ dichotomy seems to mean that, if you are creating a market from scratch, there is no benefit and hence no subsidy. If you are providing some support in an already existing market, there can be benefit and hence subsidy. In other words, the bigger the market failure (and hence the intervention) the less likely you are to be caught. Can this be right?

One immediately wonders whether this test could apply to other scenarios, and in particular to which ones. What about the large civil aircraft (‘LCA’) sector which caused the biggest transatlantic ‘Boeing-Airbus’ trade row. This is a sector where arguably you would not see a single aircraft in airports’ runaways without massive public support right at the beginning of the production process. Could the ‘market creation’ apply? If so, WTO dispute settlement would have spared huge resources that have strained the system. But, this begs another question: would Members be happy about having the LCAs industry sheltered from subsidy control altogether?

sensibility, and at the same time, it is argued, is more consonant with the purpose and structure of WTO subsidy laws. We will delve into this point soon.

#### h. Conclusions: from genesis to nemesis

The previous review of the main steps of the reasoning of the Panel and the Appellate Body show the serious legal and economic faults that, in our view, constitute the *nemesis* of legal methodology. The path to reconcile law and policy and distinguish the ‘bad’ from the ‘good’ had – to a significant extent – produced the ‘ugly’ in terms of legal analysis.

In this respect, we should immediately underline that we do not see any major difference between the Panel (majority) and the Appellate Body. We really have ‘more of the same’, with the appeal court perhaps using a more sophisticated approach, attempting to distance itself from the marked policy-oriented language of the Panel, to rely on more objective and economic-based criteria. In the end, however, it is mainly a fine-tuning and ultimately cosmetic exercise. The approach and the result are essentially the same. Our argument does not therefore distinguish between the two. The same criticism is equally applicable to both.

In a nutshell, the ultimate methodological misunderstanding, which underlies all legal and economic errors just reviewed, is the *conflation of the question of the existence of a benefit, and hence a subsidy, and the question of the justification of the subsidy*. More specifically, the problem is the anticipation, and the acquisition, of justification considerations at the level of the arguably preliminary level of the definition of subsidy.<sup>59</sup>

Now, why is it important to keep existence and justification of subsidy separate? Let’s develop this argument a bit.

Subsidy laws and control are increasingly subject to criticism. The key point is that, at best, they do not make a good job in distinguishing good from bad governmental intervention and, at worst, they may even deter further commitments of liberalization.<sup>60</sup> Assuming now that subsidy laws do make sense (since this paper perspective is that of the judge-interpretor, not of the legislator), it may be accepted that it is important that subsidy laws, and each element of the system of subsidy control, are interpreted in the light of what seems their practical goal. In a word – the approach cannot but be at the same time purposive and systemic. Objectives matter, the design of the system of control and accordingly the regulatory framework matter too.

The conclusion that subsidy laws do not apply at all to certain measures of support is just the beginning of the analysis of the possible policy implications of the *Canada – Renewable Energy/FIT*. The intended goal and effect of the ruling, and its most immediate impact, is certainly that certain out-of-the-market subsidies are made safe. In itself this may seem just a legitimate clarification of the notoriously ambiguous contours of what does and does not amount to a subsidy. (And the notion of ‘benefit’ is a good example in point.) In the end courts, at both the domestic and international levels, are there to clarify the law. But there are other important consequences to bear in mind.

First, even assuming the correctness of the Appellate Body’s approach, it becomes crucial to be clear in terms of the precise boundaries of the carve-out and to provide for strict conditions and procedural rules to ensure that this flexibility is not abused. In other words, if we want to allow a certain degree of compensation of costs of certain legitimate activities, we need to know which costs are covered and how they are calculated. Ideally, to avoid undue distortions, we also want to keep

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<sup>59</sup> The ultimate root cause of this problem lies in the fact that we do not have a clear rule telling us what is good subsidy (but still a subsidy) and what is bad subsidy (but still a subsidy).

<sup>60</sup> See Sykes, ‘The Questionable Case for Subsidies Regulation: A Comparative Perspective’ (2010) *Journal of Legal Analysis*, p. 473.

them at the minimum level necessary to achieve the goal. We thus need clarity on the substantive and procedural mechanism of compensation to avoid that the carve-out is abused.<sup>61</sup>

Secondly, as repeatedly noted, the creation of a carve-out means that those measures falling in it are not subject to subsidy laws since they do not constitute ‘subsidies’ in the first place. Now, this has important systemic consequences for transparency and the monitoring of subsidies.

It is here important to consider the goal of subsidy control. The central idea is to subject certain measures that may distort international trade by impairing market access and distorting competition to supranational scrutiny. The net is thus cast wide, to catch those measures, coming within certain categories of public action, which have the potential to alter the level playing field by conferring specific benefits. This, in simple terms, is our understanding of the goal of the definition of subsidy in the WTO SCM Agreement. It is the legal device used to determine whether a certain measure may raise concerns and, if so, to subject it to control. More specifically, if the subsidy is also specific (ie it is not broadly available across all industries of the economy) or if, in any case, ‘operates directly or indirectly to increase exports or reduce imports’,<sup>62</sup> it will be subject to the first GATT commandment on subsidies, the obligation of transparency.<sup>63</sup>

It is crucial to highlight that to trigger the application of transparency disciplines, no precise analysis of the effects of the measures is necessary, and not by chance. The transparency threshold operates for all subsidies that may, arguably even potentially, produce undesired effects, and not only for those that will actually (or presumptively) do so.

This approach can be understood if the purpose of transparency is considered. Transparency serves to facilitate peer-control. The idea is that, in the relevant committee, questions may be raised and answered, and, if in the process concerns with respect to the impact of the measure arise, the granting government may be called to justify its subsidies (better justify their negative effects) with its peers. In other words, the real or presumed trade impact of the measure becomes relevant only when it comes to decide whether the subsidy is permitted or prohibited, which is a separate issue from the commitment of being open about one’s subsidies. To continue with the fishing metaphor, once the shore is reached, the fishermen will subject the harvest to further inspection – the good fish is separated from the bad one, and only the latter is thrown away.

Again, this process may be imprecise. Most importantly, the ultimate act of differentiation may be incorrect. Type 2 (ie under-inclusion) or, maybe more worryingly, Type 1 (over-inclusion) may be

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<sup>61</sup> This means to impose conditions of transparency, proportionality, and also the use of bidding procedures. This is the route followed in the EU with respect to the financing of the costs of public service obligations in the landmark Case C-280/00 *Altmark* [2003] ECR I-7747. If the four conditions laid down by the ECJ are satisfied, there is no advantage and no state aid.

<sup>62</sup> Specificity, defined in Article 2 of the SCM Agreement, is a tentative proxy of the possible preferential treatment of certain companies or sectors. According to Article 25.2 of the SCM Agreement, Members must notify subsidies that are specific. In addition to this, Article 25.1 does refer to GATT Article XVI:1 which more generally requires that any subsidy which ‘operates directly or indirectly to increase exports or reduce imports’ is subject to notification. This seems to indicate that any subsidy that distorts cross-border trade should be subject to notification, irrespective of whether it is specific or not. This reading finds confirmation in the official questionnaire drafted by the SCM Committee. See ‘Questionnaire Format for Subsidy Notifications under Article 25 of the Agreement on Subsidies and Countervailing Measures and under Article XVI of GATT1994’ World Trade Organization, Committee on Subsidies and Countervailing Measures, G/SCM/6/Rev.1, 11 November 2003, whose Article 1 reads: ‘The following subsidies are subject to notification under Article 25 of the Agreement on Subsidies and Countervailing Measures and under Article XVI of GATT 1994: (a) all specific subsidies, as defined in Articles 1 and 2 of the Agreement on Subsidies and Countervailing Measures (“the SCM Agreement”), shall be notified pursuant to Article 25.2 of the SCM Agreement; and (b) all other subsidies (i.e., in addition to those described in (a)), which operate directly or indirectly to increase exports of any product from, or to reduce imports of any product into, the territory of the Member granting or maintaining the subsidies, shall be notified pursuant to Article XVI:1 of GATT 1994.’

<sup>63</sup> See GATT Article XVI:1.

made. But this may depend on the design of the substantive rules and their assessment. It does not - cannot - detract from the importance of transparency, which, if any, may improve the quality of the assessment of the measure through its deliberative process. Through transparency the system casts its light on potentially troublesome subsidies, through transparency it should enable to eventually discuss their effects and assess them.

Now, the implications for transparency of the carve-out created judicially by the Appellate Body at the level of the definition in the *Canada – Renewable Energy/FIT* case can be fully appreciated. If in the first place there is no subsidy, there is, legally, no duty to notify the measure to the WTO and hence the opportunities for monitoring and peer-control diminish dramatically. A privileged channel of information is blocked. This leads us to the third and final comment. The possible impact of the Appellate Body's approach can be properly appreciated if the generality of its innovations – the need to perform a market definition, and the broad concept of market creation – are considered. There is nothing prescribing to apply them only to the case at hand, or to the renewable energy or even to the energy sector only. Nothing precludes that these broad findings, which raise the bar for establishing the existence of a subsidy, could apply more generally to other subsidy cases too. The possible magnification of the concerns for abuse, undue distortions and lack of transparency is clear.

It is difficult to think that these considerations did elude the WTO adjudicating bodies. How can one explain the said nemesis? Is it really possible that neither the Panel nor the Appellate Body were aware of what they were doing, and of the possible future consequences of an incorrect legal and economic analysis? In the next two sections we advance two possible answers.

### ***First doubt: a pantomime?***

It may be useful to recall at this point the policy narrative that has been outlined at the beginning of the paper, and in particular the Manichean distinction whereby LCRs are 'bad' policy, whereas FITs are 'good' policy. By now it should also be clear to the attentive reader that the legal reasoning and the outcome of the case did fully reflect this dichotomy. While there was no hesitation in striking down the LCR element of the Ontario FIT Programme, the Panel and especially the Appellate Body were at pains to make sure that the FIT be made safe under subsidy laws. What eventually emerged, as has been seen, is a judicially created shelter for certain types of out-of-market green energy incentives.

### **Play your part**

In a dramatic piece, everyone has a part to play. It is through this lens that we make one step backwards now and look at the stance of the main players in the litigation.

*Statements in the litigation.* First, there are significant traces in the reports showing that they were fully conscious of the huge policy significance of the case, and took every opportunity, especially in the nodal points of the process, to ensure that this significance be made fully manifest. The complainants – Japan and the EU – set and sustained the pitch of the 'black-and-white' policy narrative. Suffice quoting one of the very first paragraphs in the Panel's report where, immediately after the brief summary of the measures at issue and of the claims, we find:

*Throughout these proceedings [...] the complainants have emphasized that in contesting the WTO-consistency of the challenged measures, they do not question the legitimacy of the objectives pursued by the Government of Ontario through the FIT Programme of reducing carbon emissions and promoting the generation of electricity from renewable energy sources. Japan has explained that "Japan does not take issue with Ontario's stated goal of enhancing renewable energy generation" or "the government's intervention as such to internalize the positive externalities of renewable energy generation technologies". Likewise, the European Union does not "contest the general purpose of the FIT Program, as helping to promote electricity supply from renewable*

energy sources”, highlighting that “[s]uch a purpose is legitimately valid and ... WTO Members can and should actively support it”.<sup>64</sup>

Having clarified what the complainants considered legitimate, the paragraph goes on to explain what worried them:

What the complainants call into question is *limited* to the alleged trade-distortive element of the challenged measures, which they identify to be the “Minimum Required Domestic Content Level” given effect through the FIT Programme and the FIT and microFIT Contracts. According to the complainants, this aspect of the challenged measures affords a form of WTO-inconsistent protection to producers of certain types of equipment used to generate electricity from solar and wind energy (“renewable energy generation equipment”) that are based in Ontario to the detriment of competing industries in other WTO Members, and should therefore be eliminated. Thus, as Japan has declared, these dispute cannot be properly characterized as “trade and environment” disputes, but rather, they should be thought of as “trade and investment” disputes.<sup>65</sup>

The insertion of this paragraph at the very beginning of the reports is self-explanatory with respect to the Panel’s awareness of the policy dimension of the case, of its importance and of the main terms of the debate. Confirmation of the Panel’s awareness that it was stepping on sensitive ground comes out when it was about to come to the conclusion that the measures at issue did contravene WTO laws. At paragraph 7.153 of the reports, the Panel seems to almost shy away from the just found rejection of Canada’s defence that the FIT Programme, constituting public procurement, be excepted from the prohibition of non-discrimination. We read:

In coming to this conclusion [that Canada cannot rely on the public procurement exception], we express no opinion about the legitimacy of the Government of Ontario’s objective of promoting the use of renewable energy in the production of electricity through the FIT Programme. Our conclusion that the Government of Ontario purchases electricity under the FIT Programme “with a view to commercial resale”, within the meaning of Article III:8(a), must be understood only as a judgment about the extent to which Canada is entitled to rely upon Article III:8(a) of the GATT 1993 to maintain a measure that is alleged to discriminate against imported products under the terms of Article III:4.<sup>66</sup>

Anticipating the inevitable - the finding that, once subject to the normal rules, the measures did grossly discriminate domestic and imported products – the Panel is anxious to reaffirm it is not questioning the legitimacy of the green objectives underlying the measures. This paragraph simply states what in legal terms is obvious but, in doing so, it exemplarily shows the relentless policy dimension of the case.

*Litigation strategy.* It is also interesting to note the litigation strategy of the complainants, and the reaction of Panel and Appellate Body to it.

As usually is the case, a complainant puts forwards various lines of argumentation when attacking a measure, with the easier and more convincing one first. The first step of any subsidy claim is to show that the measure does fall within one of the categories of governmental action of Article 1 of the SCM Agreement. There are two main types of action under this provision, first those falling within the straits of one of the fairly detailed forms of financial contribution, and secondly those captured by the fairly open-ended and surprisingly unexplored language of ‘any form of income or price support’. It should be noted that both call for what is largely a formalistic exercise. There is clearly no need to consider the objectives and impact of the measures at this stage.<sup>67</sup> Bluntly, it is essentially a matter of pigeonholing.

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<sup>64</sup> Para 7.7 of the Report. Footnotes in the original text omitted, emphasis added.

<sup>65</sup> Ibid, emphasis added.

<sup>66</sup> Emphasis added.

<sup>67</sup> This can be contrasted with the analysis called for by the benefit language that may, at least on its face, call for a more substantive assessment where aims and effects of the measure are both considered.

Now, Japan and the EU put forward arguments in both respects. But, as we hinted at, if a good lawyer always tries ‘in the alternative’ various routes, she or he usually begins with the stronger one. In this case, it is clear to us that to prove that the Ontario FIT Programme was a form of ‘price support’ was definitely less energy and intellectually consuming than to follow one of the financial contribution alternatives. Two quick facts confirm this. First, the complexity of the arguments and analysis of the financial contribution points which clearly comes out from the reports. Secondly, the good guidance on the concept of ‘price support’ given by the Panel in the *China – GOES* case just few months before the *Canada – Renewable Energy/FIT* case.<sup>68</sup> But this is not what happened in the case. Having found that the programme did constitute a financial contribution being a ‘purchase of goods’, the Panel did exercise judicial economy on the ‘price support’ claim. The Appellate Body confirmed the soundness of this decision.

What is the point we are trying to make? The fact that the complainants did follow first the difficult and then the easy routes, while the adjudicating body only pronounced on the former – with all the actors engaging in a complex analysis (and, yes, eventually a positive finding that measure was a form of financial contribution) is, in our view, another indication of the *reluctance* to call the Ontario FIT programme a subsidy. In other words, why have both the parties and the adjudicating bodies followed such an inefficient and paradoxical approach? If something like judicial economy does exist, it should be taken seriously. This would have meant to immediately address the ‘price support’ argument and quickly (ie with few steps of reasoning and few paragraphs of narrative - brevity is a virtue) solve the point. What – again in the name of judicial economy – should have been spared was the intricate question and analysis of whether the complex Ontario’s regulatory framework fitted one of the specific forms of financial contribution. But, alas, legal clarity and efficiency may not always be welcome. Mudding the waters is a good way to detract the attention and soften the pill. And, in doing so, you may also avoid touching sensitive ground. The crux of the issue is that the potential of the ‘any form of income or price support’ is known. This could represent an easy gateway to cover FITs and *other regulatory measures* of support in the green sector and beyond – a result to steer away from.<sup>69</sup>

*Reactions to the report.* Also the reactions of parties after the Panel and Appellate Body rulings follow the binary pattern of the policy narrative espoused at length so far. With identical (verbatim) language the EU welcomed both rulings noting that: ‘The EU supports the promotion of renewable energy but considers this must be done in a manner consistent with international trade rules.’<sup>70</sup> In the aftermath of the Appellate Body decision, John Clancy, the EU Trade spokesperson highlighted: ‘Today’s ruling is good news for everyone caring about clean energy and the environment: it has been made clear that use of quality, cost-effective technologies should not be hampered by protectionist measures’.<sup>71</sup> In similar language, in Japan, Mr Motegi, Minister of Economy, Trade, and Industry noted that ‘The [Appellate Body’s] Report supported the main claims of Japan and ruled that the local content requirements under the Feed-in Tariff Program in Ontario are inconsistent with the related

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<sup>68</sup> Guidance which could not passed unnoticed since this was the ‘official’ interpretation of the term ‘price support’ in the WTO era, and the first since an old 1960 GATT Panel report.

<sup>69</sup> Even more telling is the fact that there was no discussion of whether ‘energy’, and in particular ‘electricity’, is a ‘good’ or a ‘service’. The Panel did simply take note that the parties seem to agree it was a good. The issue did not come out before the Appellate Body. In fact, the classification of energy as either a good or a service is highly significant. Had energy been considered as a service, the WTO subsidy disciplines would have simply not applied (the SCM Agreement only applies to subsidies to goods). The TRIMs and GATT III claim would equally have been put aside. National treatment considerations would have still been relevant but the analysis would have focused on the GATS and the commitments taken by Canada in its schedule for the relevant sectors.

<sup>70</sup> Press Release, ‘EU Welcomes WTO Report on Ontario Energy Programme’, 19 December 2012, available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=861> (last access, 15 January 2014); Press Release, ‘Ontario’s Energy Programme: EU Welcomes WTO Ruling in Support of Green Energy’, 6 May 2013, available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=895> (last access, 15 January 2014).

<sup>71</sup> Press Release, ‘Ontario’s Energy Programme: EU Welcomes WTO Ruling in Support of Green Energy’, 6 May 2013, available at <http://trade.ec.europa.eu/doclib/press/index.cfm?id=895> (last access, 15 January 2014)

WTO Agreements. This is the first case that a measure providing preferential treatment to domestically manufactured goods under the Feed-in Tariff Program is WTO-inconsistent. Japan considers this ruling can be highly evaluated from the viewpoint of preventing protectionism in renewable energy sector, which can be regarded as a major growth industry.<sup>72</sup>

In sum, the acceptance of this policy narrative did shape litigation strategy and discourse, and also informed the actual legal analysis. The presence of pressing policy concerns - the need to reach a delicate legal settlement where ‘bad’ green support is distinguished from the ‘good’ one - played a role in the parties’ and especially the adjudicators’ attitude. On the one hand, the Ontario FIT Programme was found to fall within one of the eligible forms of public action in the subsidy definition but only using the hard way. On the other hand, the special policy goals of the FIT were accommodated through the legal requirement whose interpretation could more easily open up to policy considerations, that is the notion of ‘benefit’ in the definition of subsidy.<sup>73</sup>

For these reasons, the dispute more than ‘trade and environment’ (as some green NGOs depicted it) or ‘trade and investment’ (as Japan characterized it) can be better defined as one characterized by the *dialectics between law and policy*, by the tension between an extremely policy-charged narrative and the often uncertain and hence pliable legal language.

#### Unexpected principal actors

In a principal-agent framework, it seems clear to us that the Panel and the Appellate Body have indulged in gap-filling when construing the benefit, and they did so in the belief that this best corresponded to the principals’ will.

In their recent mapping of the politics of treaty interpretation, Pauwelyn and Elsig suggest that in presence of ‘salient’ decisions (ie decisions where ‘principals and the broader community care about the outcomes of courts’), courts would tend to be less autonomous and creative in their interpretation.<sup>74</sup> Moreover, courts would tend to be more activist as the ‘divergence of interests among the principals’ increases. If these insights are correct, this case may well represent a variation, if not an exception, to the rule.<sup>75</sup> The decision to be taken in the *Canada – Renewable Energy/FIT* cases was certainly ‘salient’ but the relative ‘autonomy’ or indeed ‘activism’ showed by the Panel and the Appellate Body in their construction of the benefit cannot be explained in terms of ‘divergence of interests among the principals’. It may be counterintuitive but it is argued that the undercurrent of these disputes is a substantial agreement with respect to the key rules of the game in what is increasingly a key economic sector: LCRs are bad, FITs are good. Full stop. Both the Panel and Appellate Body acted knowing this, and anticipating that their findings, by closely reflecting this agreement, would have been accepted.

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<sup>72</sup> ‘Statement by Minister Motegi, Minister of Economy, Trade and Industry on circulation of the WTO Appellate Body Report on Certain Local Content Requirements under the Feed-In Tariff Program in Ontario, Canada’, 7 May 2013, available at <http://www.meti.go.jp/english/speeches/20130507.html> (last access, 15 January 2014).

<sup>73</sup> It is this light that the decision to exercise judicial economy and not to rule on whether Ontario FIT programme was form of price support can also be viewed at. Although this element is perhaps less prone to be subject to policy considerations, a positive finding could have had far-reaching consequences. What we could call a *political* exercise of judicial economy. See Busch and Pelc, ‘Ruling Not to Rule – The Use of Judicial Economy by WTO Panels’ in Broude, Busch and Porges, *The Politics of International Economic Law*, Cambridge, Cambridge University Press, 2011, p. 263.

<sup>74</sup> Pauwelyn and Elsig, ‘The Politics of Treaty Interpretation: Variations and Explanations Across International Tribunals, in Dunoff and Pollack (eds) *Interdisciplinary Perspectives on International Law and International Relations: the State of Art*, New York, Cambridge University Press, 2013. pages 445-473.

<sup>75</sup> Ibid.

## The pantomime

Making one step forward now, we have the strong impression (an intriguing hypothesis) that, against this clearly entrenched policy narrative, the litigation on Ontario FIT Programme could itself be considered as a huge pantomime where each actor played its character-role.<sup>76</sup> To be sure, the strategic element inherent in litigation makes it often akin to a play. But the point made here is different. It is not that parties to a dispute do and say certain things following a certain, often predictable, pattern. Our argument is rather that, in this case, the parties (and especially the complainants) put forward certain arguments, well knowing, however, that the political meaning of a positive response to their arguments would have actually led the Panel and the Appellate Body to reject them. In a word, they were *expecting* that, despite every possible argument, the adjudicating bodies would have *rejected* their subsidy claim.<sup>77</sup> Likewise, they were *expecting* that their discrimination claim would have *succeeded*.

This is a reasonable doubt, supported by the outcome of the case, and in particular the process that led to it, and also by Japan's and the EU's statements during the proceedings and their reaction to the release of the reports.

What everybody loathed – the local-content requirement - was surgically extracted and eliminated. The less intrusive technique to do this was the easy path of a non-discrimination finding (duly reinforced by a narrow interpretation of the public procurement defence). The Panel and the Appellate Body had no major difficulty in doing this and thus respond to the general 'no protectionism' expectations. By contrast, to pursue the path of the subsidy claim would have intruded into Members' sovereignty much more.

First, if Ontario FIT Programme had been found to constitute a subsidy, the conclusion that the latter also constituted a prohibited subsidy under Article 3.1(a) of the SCM Agreement would have been foregone, thus requesting Canada to withdraw the 'measure' 'without delay' (a rapidity of compliance which is not required for a finding of a breach of national treatment only, for which a 'reasonable period of time' needs usually to elapse). Even more crucially, it is still unsettled whether, in such a case, the 'measure' to withdraw should simply refer to the LCR or would have extended to the FIT element too, an extra reason which could justify a policy and judicial preference for *not* following the subsidy route. Secondly, by implicating a positive finding of subsidy existence, the dispute settlement organs would have laid down a symbolically dangerous precedent, especially when other disputes on green energy subsidies are pending and others may follow suit soon. We have highlighted already that WTO subsidy disciplines do not object to subsidies per se. What are apprehended are subsidies that cause negative effects on trade. This would mean that, absent prohibited export- or local-content- conditionality, subsidies supporting energy generation would be objected to only if an adverse impact on trade can be shown. This is clearly a matter of evidence, one that, however difficult, could be positively established in other cases, in presence of the right factual circumstances. If, however, the policy goal is to protect and shelter these subsidies, the best way to do this is to outline certain legal conditions that would exclude the existence of a subsidy in the first place. Consequently, both the Panel and Appellate Body successfully managed not to call a subsidy what is in fact (almost by definition) a subsidy.<sup>78</sup>

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<sup>76</sup> For a similar, thoughtful and intriguing characterization of EU state aid control, see Bishop 'From Trade to Tutelage: State Aid and Public Choice in the European Union', Presentation to Conference to ACE, Copenhagen, 2 December 2005.

<sup>77</sup> The reasons that led to filing the complaints (for example intensive lobbying by relevant special interests) do not, in our view, lessen this reading. Once the complaint is launched, you do behave in a certain way, you play the rules of the game. In this case, one strategic element is the anticipation of the adjudicator's behaviour (which may in turn be significantly affected by the expected reactions of the Membership to certain findings).

<sup>78</sup> As further elaboration of this implication, both Panel and Appellate Body may have considered that their interpretation of the benefit could have played a beneficial role for the cause of green energy support in the future, also in the knowledge

In other words, in *Canada – Renewable Energy/FIT* the subsidy part of case raised one judicial conundrum. Unlike in the national treatment claim, it was impossible to clinically separate the bad policy from the good one. Within the eyes of subsidy regulation, the two largely shared a similar fate. For the Panel and the Appellate Body (and the parties to the dispute), the immediate concern was not system coherency or transparency (which by definition is not relevant when the measure is litigated), and, this is our impression, not even that methodology had to be subjugated to reach the desired outcome, but whether the prohibition of a blatant discriminatory condition would have been fatal to the preferential tariff and subsidy as well. This had to be avoided, irrespective of the costs. The possibility of solving the case via a fairly straightforward, and limited, finding of discrimination was the easy, and eventually preferable by everybody, way out. But, at the same time, the subsidy claim was also to be disposed of.<sup>79</sup>

As epilogue to this pantomime, during the Dispute Settlement Body meeting where the adoption of the two reports was on the agenda, the US, the big third-party, did utter the final word on the case (as putative world trade leaders are expected to do). While essentially endorsing the outcome of the case, and the legal analysis on the national treatment claim (as well as the narrow construction of the public procurement exception), they made caustic remarks on the legal route the Appellate Body followed in the subsidy benefit analysis. What meaning should we give to this statement? If the deeply entrenched policy narrative (only the LCR has to be bashed, no positive subsidy determination is welcome) had to prevail, could the Appellate Body really be chastised? Could they really do much differently?

No repeat performances?

Other cases on similar measures of support to Ontario FIT Programme have been filed during the Ontario litigation.<sup>80</sup> At the time of writing, however, for none of them a Panel request has emerged from the consultations stage. For some there are rumours of settlement. Does this silence or conciliatory mood confirm, or at least provide some indications of the acceptance of the *Canada – Renewable Energy/FIT* as good reaffirmation of the main terms of the tacit agreement that has prevailed before this case? In other words, it should be asked whether this silence reinforces the reasonable conjecture that many Members may be ready to agree that, if the most blatant protectionist devices (such as LCRs) are avoided and the distortions are kept to the minimum, certain green energy subsidies can be accepted.

### ***Second doubt: a good decision after all?***

Admittedly, a different reading of the case, and essentially a positive one, is possible.

Faced with a difficult issue, with an open language, and with important policy implications, the Panel and the Appellate Body did a good job. The Appellate Body did polish the initial rough approach of the Panel. The resulting test is still general – quite probably intentionally – but the carve-out manages to capture the essence of the problem. Some good incentives that are not there to create undue competitive benefits, in a word to distort, but to correct existing market failures are allowed.

(Contd.) \_\_\_\_\_

of the chances to amend WTO subsidy rules to expressly recognize that these subsidies are as such but are also legitimate and should not be actionable are very dim.

<sup>79</sup> If our reconstruction of the case is correct, one big, pending question is *why* Japan and then the EU decided to pursue a subsidy claim in the first place, and did not limit to neatly and easily arguing that the measure was discriminatory.

<sup>80</sup> *European Union and Certain Member States – Certain Measures Affecting the Renewable Energy Generation Sector*, DS452, request for consultations by China, 7 November 2012; *India – Certain Measures Relating to Solar Cells and Solar Modules*, DS456, request for consultations by the United States, 11 February 2013. See also *European Union and a Member State – Certain Measures Concerning the Importation of Biodiesels*, DS443, request for consultations by Argentina, 23 August 2012; *European Union and Certain Member States – Certain Measures on the Importation and Marketing of Biodiesel and Measures Supporting the Biodiesel Industry*, DS459, request for consultations by Argentina, 23 May 2013.

The outer limit is correctly found in the adequacy/excessiveness of the remuneration. If the analysis and especially test are still general, further guidelines and fine-tuning will come in the future. The contours of the carve-out will be refined, any wrinkle ironed out. This generality may perhaps be intended also as a signal sent by the judicature to the Members and a symbolic invitation to act and provide the details.<sup>81</sup>

Doin' it in style?

In 1960 Llewellyn published *The Common Law Tradition*. With maybe an audacious parallel, the spirit of this assessment looks similar to those of 'Grand Style' cases. In Llewellyn's jargon, referring to a common-law context, Grand Style cases are those where policy considerations come in for explicit examination. It is the style that produces a more effective and just outcome, and one more adapted to the social needs of the period. Grand style is concerned to provide guidance for the future. The judge enjoys what is called 'situation sense', ie the 'true understanding of the facts and right evaluation of them'. As a result, the decision that emerges is a good one inasmuch as it is 'something which can be hoped, or thought, to look reasonable to any thinking man'.

Now, if we were to apply this definition, the *Canada – Renewable Energy/FIT* should certainly be considered a 'Grand Style' case. It should, however, be seriously asked whether this decision can be considered 'good' only because it looks 'reasonable to any thinking man'. Surely, legal methodology requires more than reasonableness.

Everybody does it!

Indeed, courts are often faced with difficult issues, open language, and of pressing policy considerations. In these circumstances, the temptation to make a 'Grand Style' case may be difficult to resist.

Subsidy decisions invariably produce good examples because of the intricate mix of policy and economic interests, and the vagueness and often idiosyncrasies of the law. Take some of the recent high-profile cases of the jurisprudence of the Court of Justice of European Union ('CJEU') on the definition of State aid. The CJEU had to pass important judgments in the *EDF* and *Gibraltar* cases.<sup>82</sup> Interestingly, the legal analysis focused in the main on the question of whether the measures at issue were apt to confer a selective economic advantage, a question remarkably similar to the one under scrutiny in the *Canada – Renewable Energy/FIT* cases.

In *EDF* the Court was called to decide whether the European Commission was right in concluding that France, by waiving a corporation tax claim of almost Euros 900 millions owed by at the time State-owned energy company EDF, did grant unlawful State aid. To France this was not aid but simply an investment decision that any private investor would have taken. On first instance, the General Court had quashed the Commission's decision because it was unduly formalistic by refusing to apply the Market Economy Investor Test ('MEIP') and assess whether a private investor would have acted in the same way as the French State has done.<sup>83</sup> The Court arguably surprised everybody and upheld the General Court approach. The Commission should have applied the MEIP in its assessment.

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<sup>81</sup> Interestingly also some of the people that argue that the Appellate Body has done a good job in the *Canada – Renewable Energy/FIT* case, concede that a litigation-driven clarification is not ideal and may not be enough.

<sup>82</sup> Case C-124/10P *European Commission v Électricité de France (EDF) and Others* [2012] ECR not yet reported; Joined Cases C-106/09P and C-107/09P *Government of Gibraltar v Commission* [2011] ECR not yet reported. For a commentary on these cases see Biondi, 'State Aid is Falling Down, Falling Down: An Analysis of the Case Law on the Notion of Aid' (2013) *Common Market Law Review* p. 1719.

<sup>83</sup> Interestingly, the EFTA Surveillance Authority supported the Commission's position –you cannot judge the exercise of tax powers on the basis of what private investors would do – which shows the expectations of law enforcers.

In *Gibraltar*, faced with the arduous task of analysing an overall corporate tax system under State aid law for the first time, the issue was whether a tax regime applicable to all companies set up in Gibraltar and which essentially used payroll and property occupation rather than profits as tax base did constitute State aid. The prevailing test to determine whether a tax confers a State aid is whether the tax measure at issue does derogate from the otherwise applicable general tax baseline. The European Commission indicated that it would follow this ‘derogation test’ in its practice, by expressly endorsing it in its 1998 Guidelines on Direct Taxation and State Aid.<sup>84</sup> That was not what happened, however, in the investigation of the Gibraltar tax system. According to the Commission, albeit arguably general and applicable to all companies established in the British dependency, this corporate tax system was inherently and intentionally selective. A strict (or perhaps – we would note - just a *formal*) application of the derogation test would have led to conclude that there was no aid, and this would have been unacceptable. In the judicial review to the Commission’s decision the General Court chastised the Commission. The decision was invalid since the Commission did not follow its analytical framework of analysis. This was also the view of the Advocate General, in the appeal to the Court of Justice. The Court sided with the Commission noting that State aid should be defined by reference to its effects and, crucially, independently of the regulatory techniques used.

Now, arguably the CJEU got the methodology completely wrong in both these important cases. On the one hand, it did apply the MEIP test, which is normally applied to test the conduct of public bodies in the market, to what is quintessentially not an economic activity but the exercise of the public privilege to tax (and correspondingly to renounce tax claims). Now, had the correct methodology been applied, the Court would have arguably reached a different, indeed opposite conclusion. The French action was clearly a State aid – and a particularly obvious one. On the other hand, in the *Gibraltar* case it should have followed the hard way to establish that the corporate tax system was State aid. It should have applied the derogation test clearly and to the full.<sup>85</sup> A proper application of the derogation test would arguably have led to the same result but - this is the crucial point - without violating the important requirements of a sound legal analysis.

It is important to underline that whether you use one test or another, or apply a correct or wrong methodology, is not an academic nicety only, since it does produce important legal consequences. The outcome of the case may, or may not, be the same. This, it is submitted, is in fact irrelevant. The true importance of the matter lies elsewhere. What matters is that, by the fact itself that they have to provide a statement of the reasons that led them to a certain outcome, courts *always* create precedents. In this sense, courts always decide for the future. This shows why and how legal analysis and its methodology are important. As was recently noted, in the context of the important 2012 WTO trio of disputes on the Technical Barriers to Trade (TBT) Agreement, the role of the judge is to provide correct methodology, which is the legal standard by which future disputes will be adjudicated.<sup>86</sup>

Why did the CJEU get it so wrong? At the most superficial level, one might say that these cases show the current trend of State aid jurisprudence, away from a formalistic approach, towards a more substantive or more effect-based one. Another explanation may be more institutional, and in its consequences even constitutional. The current system whereby key decisions go to the Grand Chamber (of up 15 judges) is not tenable. In the absence of minority and dissenting opinions, the price of compromise – ie bad and contradictory reasoning - is too high. This leads to the constitutional

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<sup>84</sup> Commission Notice on the application of State aid rules to measures relating to direct business taxation, OJ C384, 12.12.1998, p. 3.

<sup>85</sup> This might perhaps have led to challenge Member States’ sovereignty more directly, by questioning whether the bases of assessment of the Gibraltar tax system duly reflected the ‘ability to pay’ principle, which is commonly considered as the underlying rationale for direct taxation.

<sup>86</sup> Mavroidis, ‘Driftn’ Too Far from Shore – Why the Test for Compliance with the TBT Agreement Developed by the WTO Appellate Body is Wrong, and What Should the AB have done instead’ (2013) World Trade Review, p. 1.

question: what do we do when the Court of Justice, the ultimate arbiter of legal interpretation, gets it wrong?<sup>87</sup>

Another possible explanation – which is not certainly alternative to the previous ones – focuses on the policy pressure of these high-profile cases. This comes out particularly clear in the *Gibraltar* corporate tax systems had a long history of being perceived as unfair. What was missing was a finding under State aid law. The policy forces surrounding the *EDF* decision are more difficult to disentangle. On the one hand, considering the sheer amount of the measure (almost Euros 1 billion!), the particularly blunt course of action followed by France, coupled with the arguably clear status of the measure under the *acquis* of State aid law, and the firm *ex officio* investigating action of the Commission, one could reasonably expect a positive State aid determination. On the other hand, the perception that by enlarging the application of the MEIP test, a level playing field would have been guaranteed, together with some deference towards France (which, through its action, personified at best the *dirigiste* approach to industrial policy still common in many old and new EU countries), may go some way in explaining the eventual absolution.

Policy considerations do explain also another famous EU State aid case, *PreussenElektra*, which bears a strong resemblance with the *Canada – Renewable Energy/FIT* cases. What was at issue was the German FIT, often considered the prototype of incentives in the green energy sector.<sup>88</sup> German legislation required regional distributors of electricity to buy all green energy produced in their area at a minimum, above-the-market price. Was it State aid? Could it be an obstacle to free movement since, obviously, if you had to source all your requirements locally, you would not get them across the border (in the instant case Austria)? If illegal, perhaps even because discriminatory, could this practice be justified because it did support the green economy revolution?

The Court eventually concluded that the measure was environmentally justified (although it did represent a measure having an equivalent effect to a quota). What matters for our purposes, however, is that, contrary to what the Commission had argued, the Court denied it could amount to a State aid because there was no sufficient use of ‘State resources’.

Leaving aside for a moment the question of whether the Court got it wrong in requesting a ‘cost-to-government’ as requirement of the definition of State aid,<sup>89</sup> what is clear is that the judgment can be largely explained in policy terms. Following the Opinion of Advocate General Jacobs, the Court wanted to exclude the risk that too many measures could be subject to State aid control. Importantly, this ruling’s implications go well beyond green energy. It is a ruling about ‘regulatory’ subsidies, the true elusive frontier of any subsidy control system.

It is argued that there is a lot in common in the motivations of the European judges in the *PreussenElektra* case and the WTO majority panellists and Appellate Body members in the *Canada – Renewable Energy/FIT* disputes. Both cases focus on regulatory measures. The will to draw boundaries in the case at issue, and most importantly in future cases, is the same. The reluctance to follow the path of State aid control – which provides in both systems for different but always-

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<sup>87</sup> We cannot really expect any kind of legislative action to redress the situation in areas like that of State aid, and especially with respect to issues such as the definition where treaty language is intentionally incomplete and the role of the Commission is limited, and in any event subject to Luxembourg’s case-law.

<sup>88</sup> Interestingly, Ontario itself expressly considered the German experience as source of inspiration in the drawing up of its own FIT Programme. See Howlett and D’Aliesio, ‘How Samsung became an Ontario election flashpoint’, *The Globe and Mail*, 29 September 2011.

<sup>89</sup> See Rubini, ‘Brevi note a margine del caso *PreussenElektra*, ovvero come ‘prendere seriamente’ le norme sugli aiuti di Stato e la tutela dell’ambiente nel diritto comunitario’ (2001) *Diritto Comunitario e degli Scambi Internazionali* p. 473. For a more recent account of the case-law of the Court of Justice on this issue, see Rubini, ‘The Elusive Frontier: Regulation under State Aid Rules’ (2009) *European State Aid Law Quarterly* p. 277.

significant transparency duties – is the same.<sup>90</sup> And the two EU and WTO cases can be companioned with each other also from the perspective of the methodology used to reach the policy outcome. Just like the *Canada – Renewable Energy/FIT* ruling is wrong because it misconstrues the notion of benefit, and via this the legal concept of subsidy itself, the *PreussenElektra* case is wrong because it incorrectly introduces in the definition of State aid a requirement (need for ‘cost to government’) and uses it as technical fudge to implement a policy decision of exclusion of State aid control.<sup>91</sup>

To conclude

In conclusion, whether a legal decision is good or bad cannot be resolved through a loose test of *reasonableness*, and crucially – this paper’s point - does not depend only on whether the *outcome* of the judicial process is acceptable. The methodology used in the process, and in particular its integrity, is as much as, if not more, important than the result.

Before developing the lessons of the case for methodology in legal analysis, however, we briefly delve into how the case should have been decided.

### ***How the case should have been decided***

The *Canada – Renewable Energy/FIT* case was an important case because it provided both the Panel and Appellate Body with the opportunity to clarify key concepts of the definition of subsidy under Article 1 of the SCM Agreement and develop its jurisprudence. The significance of the disputes went beyond the green economy sector to affect the proper understanding and operation of the WTO system of subsidy control in itself. What *could have* emerged from these disputes was a well-balanced notion of subsidy, eventually clarified in all its constituent elements.

The reader may be assured - the time for, hopefully constructive, criticism has now ended. But those that criticise have also the responsibility to offer their own solution. The *pars construens* must always follow the *pars destruens* of the argumentation.<sup>92</sup> We here offer our view on how the case should have been decided, focusing on the ‘benefit issues’ and highlighting the legal reasoning what should have underpinned this solution. In doing so we summarize the points made in the amicus curiae submitted before the Appellate Body.

First, the definition of subsidy is a threshold issue. It is simply the main gateway to subsidy disciplines. Through an assessment that is inherently preliminary, often imprecise and pragmatic, its goal is to select some measures of public support and subject them to the relevant disciplines.

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<sup>90</sup> After unloading State aid control, the two courts follow different paths (in one case by striking down the local-content requirement, in the other by scrutinising and then justifying the purchase obligation). It may well be, however, that the different treatment – prohibition vs justification – of the two discriminatory elements do follow a similar logic. While the Ontario’s device is clearly protectionist (and directly affects the technology market), the German purchase obligation had the green goal to boost the generation of renewable energy itself, and its foreclosure effect was justified by the immaturity of the energy internal market (ie lack of certification) at the time of the decision.

<sup>91</sup> This was duly noted by Advocate General Maduro in the Opinion in the Case C-237/04 *Eniriorse II* [2006] ECR I-2843. It is interesting to note that there seems to be a policy change with respect to the requirement of ‘State resources’. While the Commission was never happy about it, through an often-convoluted case-law, the EU Courts did consistently support the need for this requirement. The tide seems to be changing now. Consider the recent generous constructions of the definition of State aid, put forward by the Commission and endorsed by the Court of Justice in Joined Cases C-399/10P and 401/10P, *Bouygues v European Commission*, judgment of 19 March 2013, nyr. If not an open overruling of *PreussenElektra*, this jurisprudence does point to an adjustment of the approach to the definition of State aid which may also lead to a stricter approach with respect to those measures of green energy support policies which are no more considered to be necessary and hence desirable.

<sup>92</sup> Both draw on the author’s conceptual framework in *The Definition of Subsidy and State aid: WTO law and EC Law in Comparative Perspective*, Oxford, Oxford University Press, 2009.

Secondly, in approaching the interpretation of the definition of subsidy it is important to recall that:

- language, requirements and tests of the definition should be interpreted having in mind the purpose of the definition and the objective of the relevant disciplines;
- as said, the definition requires an analysis that is only preliminary, and as such should not exhaust the assessment of the measure;
- since potentially several measures may produce effects similar to subsidies, for practical and other reasons, the meaning and scope given to the legal notion of subsidy should not be excessive.

Thirdly, the objective of the benefit analysis, which is broadly the same of the definition of subsidy, is fairly simple. It is there to capture those measures that have the potential to distort trade. No more, no less. No comprehensive analysis to conclusively determine whether this potential has translated into actual harm is necessary, no consideration of the redeeming, even if legitimate, objectives of the measures is permitted.

Fourthly, it bears repeating that the Panel majority's and the Appellate Body's analysis of the benefit is fundamentally wrong because it confuses and conflates the question of the economic and policy justification of the subsidy with the different and separate question of its existence.

Fifthly, the Ontario FIT Programme represent, in its stated goal and resulting effect, a deviation from what the electricity market, left to its own forces, would have normally provided, and, as also comes out clearly from litigation, this deviation is advantageous for the eligible wind and solar renewable energy generators. In legal terms, this is a 'benefit'. This is, at heart, the 'no-nonsense' approach of the dissenting Panellist. This is the intuitive approach that the European Court of Justice did endorse in having to judge the German FIT of the *Stromeinspeisungsgesetz* in 2001:

there is no dispute that an obligation to purchase electricity produced from renewable energy sources at minimum prices ... confers a certain economic advantage on producers of that type of electricity, since it guarantees them, with no risk, higher profits that they would make in its absence.<sup>93</sup>

Sixthly, the fact that the market is even fundamentally distorted, to the extent that the public hand artificially creates it, does not represent an obstacle to – but rather evidence for – the determination of the existence of a benefit. It is still the market standard that is at work, albeit in an extreme setting. From another perspective, the fact that a 'competitive market' producing the desired outcome does not exist (or even that it could not possibly exist), and that it is only because of government intervention that the desired 'public goods' are supplied, is in itself evidence of a subsidy scenario. With the risk of appearing paradoxical, and despite the obvious intricacies of Ontario's FIT Programme and the relevant energy market, this case is a textbook example of the existence of a benefit and hence a subsidy.

Seventhly, as noted, policy concerns can play only a limited role in the benefit analysis. The main conceptual fault of both the Panel majority and the Appellate Body is the continuous negation of the marketplace as benchmark on the basis of the inability of the market to ensure a supply of electricity that meets the objectives sought by the government of Ontario. But whether the regulatory framework appropriately takes into account the interests and objectives of subsidies is not the question that should be asked and answered by dispute settlement. It is ultimately a question that Members and their negotiators (that are fully accountable to their constituents and citizens) – and not adjudicating bodies - have to answer.<sup>94</sup>

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<sup>93</sup> See Case C-279/98 *PreussenElektra* [2001] ECR I-2009, paragraph 54.

<sup>94</sup> Calls for reform of subsidy rules, especially with respect to green energy support, are numerous. See, eg. Howse, 'Do the World Trade Organization Disciplines on Domestic Subsidies Make Sense? The Case for Legalizing Some Subsidies', in Bagwell, Bermann and Mavroidis (eds), *The Law and Economics of Contingent Protection in International Trade*, Cambridge, Cambridge University Press, 2010, p. 85; id, 'Climate Mitigation Subsidies and the WTO Legal Framework:

For these reasons, it was indisputable, almost self-evident, that Ontario FIT Programme did confer a benefit and was a subsidy.

#### 4. The lessons of the case-study for judicial methodology

After criticizing at length approach and findings of the WTO adjudicating bodies, and suggesting how they should have dealt with the case, it is now time to draw from this case-study more general conclusions about methodology in judicial reasoning.<sup>95</sup>

To recap our analysis of the Panel majority's and the Appellate Body's reasoning, and using the distinction between 'work to rule' and 'gap filling' interpretive approaches introduced by Pauwelyn and Elsig,<sup>96</sup> two approaches were possible and were largely put forward by the complaining parties. On the one hand, the benefit could have established on the basis of a comparison with a benchmark or maybe a proxy (based on costs). This would have been faithful to previous, consolidated case-law. Alternatively, the WTO adjudicating bodies could have concluded, even on the basis of the clear statements and concessions of Canada, that the FIT did inherently and purposely confer a benefit. Although, if set in the context of the previous case-law, this latter line would probably have been a little bit more on the loose arguably both approaches would have been 'working to rule'. But both the Panel majority and Appellate Body went too far, and did undoubtedly resort to 'gap filling'. This is the essence of the compassionate and holistic approach of the Panel. This is the result of introducing the concept of a carve-out, duly prepared by an erroneous narrow definition of the market, as the Appellate Body did. If you wish, both rulings are activist constructions of the concept of benefit. Coupled with this, and in the context of the same judicial strategy, there are some good reasons to opine that also the narrow interpretation of the public procurement exception is more on the 'gap filling' rather than 'working to rule' side.

Now, is this gap filling or activism unwarranted? What does it tell us in terms of methodology in judicial analysis? In the next short paragraphs we attempt to answer these questions delving into the notions of integrity and coherence, courage and legitimacy, process and outcome.

(Contd.) \_\_\_\_\_

A Policy Analysis', International Institute for Sustainable Development, May 2010; Rubini, 'Ain't Wasting Time No More: Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform' (2012) *Journal of International Economic Law*, p. 525; Horlick and Clarke, 'WTO Subsidies Disciplines During and After the Crisis' (2010) *Journal of International Economic Law* p. 859; Aerni et al., 'Climate Change, Human Rights and International Economic Law: Exploring the Linkages between Human Rights, Trade and Investment' (2010) *German Yearbook of International Law*, p. 139; Bigdeli, 'Resurrecting the Dead? The Expired Non-Actionable Subsidies and the Lingering Question of "Green Space"' (2011) *Manchester Journal of International Economic Law*, p. 27; Steger, 'The Subsidies and Countervailing Measures Agreement: Ahead of its Time or Time for Reform?' (2010) *Journal of World Trade*, p. 779. These calls for reform have been repeated after the *Canada – Renewable Energy/FIT* litigation. See, eg, Casier and Morenhout, 'WTO Members, Not the Appellate Body, Need to Clarify Boundaries in Renewable Energy Support', International Institute for Sustainable Development, July 2013; Cosbey and Mavroidis, 'A Turquoise Mess: Green Subsidies, Blue Industrial Policy and Renewable Energy: the Case for Redrafting the Subsidies Agreement of the WTO' (2014, mimeo, on file with the author).

<sup>95</sup> The literature analyzing and commenting on WTO Panel and Appellate Body reports is rich and very sophisticated. Praise is common, but so are criticisms, as in this paper. For two recent examples of strong criticism of the Appellate Body's jurisprudence, see Cartland, Depayre and Woznozski, 'Is Something Going Wrong in the WTO Dispute Settlement?' (2012) *Journal of World Trade*, p. 979; Stewart, McDonough, Smith and Jorgensen, 'The Increasing Recognition of Problems with WTO Appellate Body Decision-Making: Will the Message be Heard?' (2013) *Global Trade and Customs Journal* p. 390. We cite these two as notable example because the authors are high-profile former negotiators of the Uruguay Round that led to the WTO, one former director of the Rules Division of the WTO Secretariat, leading practitioners and authors of a very authoritative account of the Uruguay Round negotiations. Even more interesting is that the motive of this criticism is often traced to few subsidy decisions.

<sup>96</sup> Pauwelyn and Elsig, see note n. 74 above.

### ***Integrity and coherence***

The normative claim of this paper is that methodology matters in legal interpretation and more specifically that integrity and coherence are essential values in legal (read: judicial) reasoning. Integrity and coherence are the polestar of any interpretive exercise. It often takes bravery to stick to them, but it is only by abiding to them that judicial activity may respect and enjoy legitimacy. The corollary of the integrity-and-coherence claim is another claim, which will be developed below, whereby, in legal reasoning, process and methodology are more important than real or perceived just outcomes.

When we talk of integrity in legal reasoning we are not referring to anything exotic. We just allude to that reading of the law that, in Dworkin's world, offers its best justification, the one that best fits and justifies the law as a whole, in our case WTO subsidy disciplines.<sup>97</sup> Within this context, coherence is one particular aspect of integrity, which is there to underline the imperative to consider the law in its entirety when performing legal interpretation.<sup>98</sup> In other words, integrity and coherence in legal reasoning are served by always placing legal interpretation in its full legal context. This requires full consideration of the objectives of the disciplines, of the specific provisions and tests within it, and of the broader system. In a nutshell, it is a healthy call for what is simply good old teleology and systemic interpretation. But, and this is the crucial twist, this call requests to go all the way to the end, without any preoccupation for the policy implications of one interpretive choice rather than another, and without impairing what has emerged as the best reading of the law using the prevailing methods of legal interpretation.<sup>99</sup>

Applying these principles to the issue of the interpretation of benefit, this would mean that the benefit test can be correctly interpreted only if its role within the context of the definition of subsidy – and the role of the definition of subsidy within the broader system of subsidy control in the WTO – are properly understood. We have previously put forward what, in our view, the correct understanding of this role is and consequently what interpretation Panel and Appellate Body should have followed. The 'right' answer would have been that the Ontario FIT Programme was a subsidy, although, in the eyes of the adjudicators (and, as we have speculated, perhaps also of the parties, and possibly the whole WTO constituency at large) this was probably not the most desirable outcome. But the Panel and the Appellate Body should have stuck to this approach and conclusion, *irrespective* of any concern or apprehension they might have had for the practical result of this interpretation in the case at issue or in other cases, and irrespective of how they thought their ruling would have been accepted.<sup>100</sup> In this scenario, the tension – better the clash - between process and outcomes comes out clearly. We will return to it.

Our criticism of the Panel majority and the Appellate Body is one of gap filling. To be clear, to follow integrity and coherence does not mean that interpretation will never require or result in gap filling – and, crucially, that policy considerations can never play a role in legal interpretation.

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<sup>97</sup> See, eg. Dworkin, *Law's Empire*, Oxford and Portland, Oregon, Hart Publishing, 1986. Although our understanding of integrity does resonate with Dworkin's famous theory of law as integrity, and the hunch is the same, it is not pretended here that there is a full overlap with it and the complexities of Dworkin's claim.

<sup>98</sup> See, eg. MacCormick, *Legal reasoning and Legal Theory*, Oxford, Clarendon Press, 1978; id, 'Coherence in Legal Justification' in Peczenick et al (eds) *Theory of Legal Science*, Dordrecht, Reidel Publishing, 1984. See also Schiavello, 'On "Coherence" and "Law": An Analysis of Different Models' (2001) *Ratio Iuris*, p. 233; Soriano, 'A Modest Notion of Coherence in Legal Reasoning. A Model for the European Court of Justice' (2003) *Ratio Iuris*, p. 296.

<sup>99</sup> This does not necessarily mean that in all cases there will be only one, 'right' answer. Especially in hard cases there may be two or even more plausibly coherent readings. But this was not the case here. The interpretive approach and solution adopted by both Panel and Appellate Body are plainly at odds with a coherent construction of the benefit, the definition of subsidy and subsidy laws and control at large. Arguably, they were confronted with only one possible reading, the one that is espoused in this paper.

<sup>100</sup> As we are about to note, even full acceptance of a ruling does not make it legitimate.

In some cases this is what the law itself – in its intended vagueness and incompleteness – require, the most notable examples being when general clauses (like necessity or proportionality) or general concepts (like public order or good faith) are employed. This may similarly happen, using WTO law as example, with the determination of whether government revenue is ‘otherwise due’ in the context of the subsidy definition, or whether, in national treatment obligations, it is necessary to decide whether there has been ‘less favourable treatment’ or treatment ‘so as to afford protection’. But this is not the case with the subsidy benefit analysis.

One concluding gloss. Our approach, with its stress on the integrity of legal reasoning and especially its indifference, if not even snub, for the latter’s policy consequences, might be tagged as unduly formalistic.<sup>101</sup> It is not. If one wanted to label it, it should be called legalist. It is about taking law and legal analysis seriously.<sup>102</sup> Ultimately, the ethos of this position is that, contrary to what many modern legal thinkers would argue, law *is not* and *cannot* be reduced to politics or to policy-oriented decision-making, carried out through other means.<sup>103</sup> Law does exist exactly to control and channel power. Rule of law-based systems are often contrasted to power-based systems. Certainly, law is about implementing policies but – that is the key point – policy-lobbying and influence, discussion and evaluation should come into play in the earlier stages of preparation and drafting of the law, not in its interpretation and application (apart from those cases where, as noted, the legal framework is itself responsive to the scrutiny of policy goals).

### *Courage and legitimacy*

We have hinted that integrity and coherence often require courage. Courage about what? The answer should be clear from our discussion on integrity in legal reasoning. Judges should be brave and resist to policy and political pressures. They clearly live – to paraphrase the Appellate Body – ‘in the real world where people live and work and die’.<sup>104</sup> They are certainly aware of expectations and implications of their rulings, but, in the end, what they have to do is to apply the law and do the best possible job in this respect. This – in our view – is what integrity and coherence suggest and require.

Take it from another viewpoint. Legal decision-makers are confronted with two types of courage. It takes bravery to fill the gaps left by legislators, but it also takes courage to restrain oneself when confronted with important (policy-wise) legal decisions and do not substitute legislators. This is the kind of courage that Panel and AB should have demonstrated in the *Canada – Renewable Energy/FIT* case.

Finally, only by following integrity and coherence judicial activity may respect and enjoy legitimacy. Three brief remarks can be made in this respect.

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<sup>101</sup> Note that there is nothing ontologically wrong with formalism, or conversely inherently right with ‘substantialism’. The important point is to have in mind both the practical nature of law – law has to be *applied* to certain conducts and events – and the objectives of the specific discipline at hand. This double analysis will tell whether, in the specific circumstances, it is better to have a rule requiring a formal or rather a substantial analysis.

<sup>102</sup> The intellectual references of this *positive* claim about legalism are numerous, dating back to the Scottish philosopher David Hume up to, more recently, Neil MacCormick. Like formalism, legalism is often perceived negatively. For a recent example, although focused on the international level, see Eric Posner, *The Perils of Global Legalism*, Chicago, Chicago University Press, 2009. In the preface to the book Posner outlines its premise concept about legalism: ‘The prestige of the law often leads to *legalism*, which is a view that loses sight of the social function of law and sees it as an end in itself, one that thinks of moral and political problems in legal categories and asks lawyers and judges rather than politicians to solve them’, p. xii). From these few notes, the reader may have understood that we endorse a different notion of legalism.

<sup>103</sup> This is indeed a common persuasion in modern legal thought, from legal realism to critical legal studies, from feminism to pragmatism. See, eg, Sunstein, *Legal Reasoning and Political Conflict*, New York, Oxford University Press, 1996.

<sup>104</sup> Appellate Body Report, *EC – Hormones*, WT/DS/26/AB/R and WT/DS/48/AB/R, paragraph. 48.

Although it is clear that legal interpretation is a process of ‘construction’, of giving meaning to language that is often vague and incomplete, there is a limit to what judges can do. This conclusion is not discredited by the ‘approval’ or ‘acceptance’ of litigating parties (and maybe, when available, even other stakeholders or the public at large) for a certain outcome, or even the way to reach it. This approval, it is argued, is not sufficient to bestow legitimacy. Neither is legitimacy a matter of perception. Legitimacy – it is argued - is about process; it is about a settlement on policy issues, which is the result of serious and transparent contestability. If this is correct, only legislative or legislative-type processes, which should encompass the direct input of most of (if not all) the stakeholders as well as significant deliberation and transparency, can ensure full legitimacy.

In other words, fundamental decisions on what is *good* and what is *bad*, especially if they involve important re-construction of the contract should be left to legislators.

From another perspective, judicial law-making has inherent limitations coming from its random nature (it is difficult to anticipate what prompts litigation and when) and piece-meal approach (adjudicators have to decide within the terms of reference of the litigating parties). Hence, it is a known fact that judicial solutions can only be partial.<sup>105</sup>

### ***Process and outcome***

The perhaps provocative corollary of the preceding argumentation, and indeed of this paper, is that, in legal reasoning, *process and methodology are more important than outcome*.

The main point is that the value, the essence of the law – as we see it - is in the *process* and *methodology* that lead to a certain outcome, not in the outcome itself. If the reached outcome is not just, we may then question the law as unjust. But we cannot question its nature as law and, more importantly, this questioning is not for adjudicating bodies that are called to apply it as it is. The responsibility for bad law cannot but reside with those that are called to make it – ie legislators. By contrast, the adjudicators would be held responsible if the outcome is the wrong one and this can be so only inasmuch as the legal analysis leading to it is wrong. In other words, *justice* is the benchmark for laws, *correctness* is the benchmark for judicial decisions. While legislators are responsible for the former, adjudicators only for the latter.

From another perspectives, process and methodology are the substance of legal reasoning and legal interpretation, which are the core of judicial analysis. Suppose courts do not have to follow any process or methodology. It could then be argued that you do not have judicial analysis either, at least in the modern, democratic sense. You may certainly have a mechanism to settle disputes, perhaps even efficiently, but – crucially – without analysis-led outcomes, the result may just be the fruit of utter arbitrariness. It would be strictly comparable to deciding disputes by flipping the coin or divining the result from the occurrence of natural events.

If process and methodology are crucial in law – better in legal or judicial activity - then *scrutiny* and *review* become essential, inasmuch as they ensure that process and methodology have been performed correctly. This goes hand in hand with the necessity of *transparency*. If you are not transparent then there is no possibility for scrutiny and review and consequently no incentive to be serious on following process and methodology.

Clearly, ultimately any law (even a legal system at large) is good only if it delivers good and just results. This does not detract from the fact there is an intrinsic and unavoidable value in the clarity and correctness of the process that leads to these results. To the point that, a good solution in the case at

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<sup>105</sup> On the differences of law reform enacted through judicial or legislative action, see Raz, *The Authority of Law*, Oxford, Clarendon Press, 1979; id ‘The Relevance of Coherence’ in Raz *Ethics in the Public Domain*, Oxford, Clarendon Press, 1994.

hand, coming out from a distortion of the law, should not be accepted at ease. Law and rules are not for ever, they should be liable to be contested and changed.<sup>106</sup> But it is only by interpreting and applying them properly that lacunae and inconsistencies may be unearthed. This is the main contribution to justice that adjudicators can bring: showing how a correct application of the law may lead to unjust consequences. If the law process is continuously tweaked to reach certain desired results, one may be led into the temptation of believing that there is no real need for change or reform. Going one step further, while occasional tweaking may be necessary and welcome, if patent and universally accepted injustices need to be avoided, this course of conduct should really be limited to exceptional cases, and cannot be light-heartedly endorsed. The clear, tangible consequence is that, by proceeding in such a way, the law would just become an empty simulacrum.<sup>107</sup>

## 5. By way of conclusion: absolve one, admonish the other

This paper has argued that the integrity and coherence of legal analysis is crucial in any adjudication decision, even if the outcome deriving from what can be considered as the correct analysis is not desirable policy-wise. To show how policy concerns can lead adjudicators to commit several serious errors in their legal and economic assessment, we have used the recent *Canada – Renewable Energy/FIT* case on renewable energy support. This is an important ruling whose findings may well extend beyond the ‘green sector’ and whose implications may be significant.

Now, at the close of the paper, the reader may feel that we may have been unduly critical of the WTO adjudicating bodies and that, considering all circumstances, they would have deserved more sympathy. In fact, on the basis of the premise that, had the law been different, they would not have been backed into a corner, we feel that there is room for excuse, if not for a justification. In other words, it is the insufficiency of the regulatory framework on subsidies, its lack of clarity on how responsive it could be to important and legitimate policy concerns, the factor that has ultimately created a pressurised environment against which the case had to be decided.

The absolution of WTO adjudicating bodies thus inevitably turns into an admonition to WTO Members. Rather than playing with fire in the litigation game, and shift the responsibility of difficult decisions on Dispute Settlement, they should take lead and responsibility and make an act of clarification of the rules, tidily indicating what type of support is permitted and what is not permitted. If Members – ie law-makers – do not act, either in a negotiating setting or in the relevant committees, litigation will be forced to act as a substitute. In the green economy, in presence of rules not fully fit for the purpose, and increasing competitive pressure coming from green investment and trade trends, this is likely. But for the reasons explained in this paper, the result may not be a pretty sight.<sup>108</sup> The very recent success in Bali may be promising and offer some momentum for government to at least reflect on what are the current priorities of reform. There is no doubt that climate change and clean energy should be high on the list.

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<sup>106</sup> To be true, this contestability is easier in some systems than in others. With a very rough approximation, experience seems to indicate that law reform is more difficult at the international level, especially if it should be endorsed through complex negotiations with several governments and various, conflicting interests at stake.

<sup>107</sup> We may conclude these reflections on the characteristic value of process and methodology in law, by asking whether the same applies in, for instance, economics. For an example where ‘process’ considerations may be more important for legal rather than economic analysis (ie where to consider the ‘purpose’ of a regulation in national treatment claims) see Broude and Levy, ‘Do You Mind if I Don’t Smoke? Products, Purpose and Indeterminacy in *US – Measures Affecting the Production and Sale of Clove Cigarettes*, Research Paper No 11-13, International Law Forum, Hebrew University of Jerusalem, August 2013.

<sup>108</sup> The case and challenges for reform of the rules on green energy support is the focus of a broader project the author is currently completing. For an initial roadmap see Rubini, ‘Ain’t Wastin’ Time No More. Subsidies for Renewable Energy, the SCM Agreement, Policy Space, and Law Reform’, (2012) *Journal of International Economic Law*, p. 525.

*What does the recent WTO litigation on renewable energy subsidies tell us about methodology in legal analysis?*

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