



European
University
Institute

ROBERT
SCHUMAN
CENTRE FOR
ADVANCED
STUDIES

WORKING PAPERS

RSCAS 2015/09
Robert Schuman Centre for Advanced Studies
Global Governance Programme-157

‘The wide and the narrow gate’.
Benchmarking in the SCM Agreement after the
Canada – Renewable Energy/FIT ruling

Luca Rubini

European University Institute
Robert Schuman Centre for Advanced Studies
Global Governance Programme

‘The wide and the narrow gate’. Benchmarking in the SCM Agreement after the *Canada – Renewable Energy/FIT* ruling

Luca Rubini

EUI Working Paper **RSCAS** 2015/09

This text may be downloaded only for personal research purposes. Additional reproduction for other purposes, whether in hard copies or electronically, requires the consent of the author(s), editor(s). If cited or quoted, reference should be made to the full name of the author(s), editor(s), the title, the working paper, or other series, the year and the publisher.

ISSN 1028-3625

© Luca Rubini, 2015

Printed in Italy, January 2015

European University Institute

Badia Fiesolana

I – 50014 San Domenico di Fiesole (FI)

Italy

www.eui.eu/RSCAS/Publications/

www.eui.eu

cadmus.eui.eu

Robert Schuman Centre for Advanced Studies

The Robert Schuman Centre for Advanced Studies (RSCAS), created in 1992 and directed by Professor Brigid Laffan, aims to develop inter-disciplinary and comparative research on the major issues facing the process of European integration, European societies and Europe's place in 21st century global politics. .

The Centre is home to a large post-doctoral programme and hosts major research programmes, projects and data sets, in addition to a range of working groups and *ad hoc* initiatives. The research agenda is organised around a set of core themes and is continuously evolving, reflecting the changing agenda of European integration, the expanding membership of the European Union, developments in Europe's neighbourhood and the wider world.

Details of the research of the Centre can be found on:

<http://www.eui.eu/RSCAS/Research/>

Research publications take the form of Working Papers, Policy Papers, and e-books. Most of these are also available on the RSCAS website:

<http://www.eui.eu/RSCAS/Publications/>

The EUI and the RSCAS are not responsible for the opinions expressed by the author(s).

The Global Governance Programme at the EUI

The Global Governance Programme (GGP) is research turned into action. It provides a European setting to conduct research at the highest level and promote synergies between the worlds of research and policy-making, to generate ideas and identify creative and innovative solutions to global challenges.

The GGP comprises three core dimensions: research, policy and training. Diverse global governance issues are investigated in *research* strands and projects coordinated by senior scholars, both from the EUI and from other internationally recognized top institutions. The *policy* dimension is developed throughout the programme, but is highlighted in the GGP High-Level Policy Seminars, which bring together policy-makers and academics at the highest level to discuss issues of current global importance. The Academy of Global Governance (AGG) is a unique executive *training* programme where theory and "real world" experience meet. Young executives, policy makers, diplomats, officials, private sector professionals and junior academics, have the opportunity to meet, share views and debate with leading academics, top-level officials, heads of international organisations and senior executives, on topical issues relating to governance.

For more information:

<http://globalgovernanceprogramme.eui.eu>

Abstract

This paper is about the future of benchmarking in the SCM Agreement after the *Canada – Renewable Energy/FIT* dispute. This case left us with bad law. The author claims that WTO dispute settlement organs are now faced with two options. After outlining the risks that a normalization-and-expansion of this ruling may pose, the paper speculates on how the much-preferable clarification-and-narrowing of the law could be done. In so doing, it draws on the significant EU experience in State aid law with respect to the use and relevance of ‘price-discovery mechanisms’, which is one of the intriguing undercurrents of the dispute. This exercise, however, exposes many challenges and difficulties, many of them already occurred in EU law. The conclusion is thus that the amount of helpful clarification the WTO judicature could offer is limited. This leads to suggest, once again, that the only solution is law reform.

Keywords

Renewable energy, subsidies, environment, WTO, dispute settlement

‘Enter through the narrow gate. For wide is the gate and broad is the road that leads to destruction, and many enter through it.’ (Gospel according to Matthew, 7:13-14)

1. Introduction¹

This piece is a comment to the *Canada – Renewable Energy/FIT* disputes. Its focus is, in particular, on the future of benchmarking after this important case. It draws on the already rich commentary, the latest example being Steve Charnovitz’s and Carolyn Fischer’s excellent paper.² Our analysis is largely complementary to theirs.

For the benefit of the reader, it is worth briefly summarizing what the case is about.

The WTO dispute settlement was called to decide whether Ontario’s feed-in tariff (‘FIT’) system, which provides incentives to renewable energy producers and critically includes a local content requirement, was in line with WTO laws on national treatment and subsidies. After easily disposing of the local content requirement, which was patently in breach of the prohibition of non-discrimination, the Panel and the Appellate Body were both asked to establish whether the measure was also a prohibited subsidy. The determination of whether the FIT was a subsidy was the preliminary step of this analysis. In this respect it was necessary to conclude that the incentive scheme was really providing a benefit to its recipients. Both courts rejected the claims, arguments and benchmarks put forward by the claimants, and concluded that they were not in a position to find for the existence of a benefit.

The Appellate Body’s reasoning in this respect is particularly important, and has been the subject of much analysis and discussion. In a nutshell, the World Trade Court introduced two innovations to its long-standing jurisprudence on the benefit analysis under Article 1 of the SCM Agreement. It first required that a full market definition analysis be carried out.³ This exercise is functional to identify the universe within which the appropriate market benchmarks can be found. Crucially, the Appellate Body found that this analysis should not stop at the demand-side substitutability but should extend to consider also the supply-side.⁴ After concluding that the market at issue in the case was that of renewable energy only (as opposed to the broader energy market),⁵ the Appellate Body introduced its second innovation. It distinguished two scenarios. Those where governments (simply) create markets and those where they intervene in already existing markets.⁶ Importantly, the former is not ‘in and of itself’ a subsidy. It also transpires that, in the first scenario, the key requirement that government creative action should satisfy to profit from this shelter is that the action of support is proportionate and not excessive. In sum, if we have a new market and the creative act is simply conducive to bring this market into existence, WTO subsidy laws do not apply. It is clear that, through this interpretation, the Appellate Body managed to take certain forms of subsidization in the clean energy sector outside of subsidy control.

Our assessment of this decision is negative. In other writings we have severely criticized both the Panel (majority) and the Appellate Body.⁷ The burning question was: How is it possible that what is

¹ The author wishes to thank the participants of the 2014 WTO Law conference in London and the ALI 2013 WTO case-law conference for useful comments on his presentation. A special thank goes to Aris Georgopoulos.

² Charnovitz and Fischer (2014).

³ See Appellate Body Report, paras. 5.167-5.179.

⁴ Appellate Body Report, para. 5.171 et seq.

⁵ Appellate Body Report, para. 5.178.

⁶ Appellate Body Report, para. 5.188.

⁷ Rubini (2014a), and the updated version Rubini (2014b); Cosby and Rubini (2013). See also Rubini (2015).

almost a textbook example of subsidy has turned out not to be a subsidy at all?⁸ More specifically, we are of the view that their interpretation of the notion of benefit amounts to a fundamental misconstruction of the law. The result is a limited but unwarranted carve-out for certain type of subsidies from subsidy disciplines. The potential implications of this exception are troublesome. If our reading is correct, it is desirable that future decisions limit the impact of this decision. Whether, and how, this is possible is the focus of this piece.

The paper is structured as follows. After a brief overview of the rich commentary already appeared on the disputes in Section 2, Sections 3 and 4 briefly review the two main innovations (and mistakes) introduced by the Appellate Body. A brief interlude on the significance of this decision for the EU (Section 5) paves the way to the examination of the two readings of the Appellate Body's benefit analysis that are now possible. Several questions are left open and the WTO judicature could either follow an expansionist reading or a narrow path. These two alternatives are discussed in Sections 6 and 7. With Section 8, the analysis draws to a close and focuses on the serious challenges that a more desirable narrow reading of the '*Canada – Renewable Energy/FIT* exception' may pose. Section 9 concludes.

2. Literature review

As testament to the true importance of the case, the commentary and analysis of these rulings quickly began after they were delivered. Most of the attention has focused on the subsidy analysis, and in particular on how the Panel and especially the Appellate Body construed the benefit test. Despite their diversity, virtually all pieces share one common denominator. Their assessment is negative.

This section aims to highlight the key findings of this literature. Its goal is not to offer a comprehensive review, but rather to convey the gist and feel of the assessment of this decision so far.

The first reactions to the decision can be found on the web, and in particular in various posts in the International Economic Law Blog.⁹ Consultancies also act quickly. Commenting on the Panel Report, economist Amar Breckenridge perceptively noted:

The reason governments choose to support the development of renewables is not primarily because of concerns regarding the adequacy and affordability of supply. Rather it is because lower emissions sources of energy, such as renewables, confer a positive benefit to society that is not normally captured by market arrangements absent some specific form of government intervention. In such circumstances, economists speak of market failure as a result of externalities. One way to address this externality is by subsidising the production of energy from renewable sources. FIT schemes are one example of such subsidies. The benefit of the subsidy accrues to the producers of energy from renewable sources. In the absence of such a benefit there would be no incentive for them to invest. The public benefit to society from lower emissions is entirely predicated on there being a private benefit to the producers of energy from renewable sources. These private benefits take the form of fixed prices over a lengthy period of time representing a significant mitigation of

⁸ See also the amicus curiae brief submitted to the Appellate Body on 13 March 2013.

⁹ The same day the Panel reports came out (19 December 2012) Simon Lester identified 'the real highlight of the report' in 'the discussion of "benefit," which led to a dissent. No quick summary of the issues at this point -- still trying to digest it.' But it was the Appellate Body report, circulated on 6 May 2013, which triggered the real debate. Simon Lester again immediately noted that, although 'there's a lot to digest in the reasoning on "benefit"', the impression was that 'they [...] tried to provide some flexibility under the SCM Agreement to governments who want to promote clean energy.' After quoting some of the key passages of the Appellate Body's decision (paras. 5.188-5.190; we will return to them later), he asked: 'How big will this *government creating a market* "exception" be? Will governments look for opportunities to use it to make financial contributions in a way that does not confer a benefit? What other goods that might not exist in a market could governments act to create?' A lively discussion on the implications of these findings followed in this popular blog.

investment risk – more so than would likely be available on commercial terms, and more than made available under contracts between government and private investors.¹⁰

This quote summarizes the economics of the case and how economists view FIT schemes. They are incentives that benefit private producers and subsidize the production of energy while tackling one or more market failures.¹¹

It is, however, the Appellate Body decision that attracted the large majority of published comments. The first ones were mainly in the form of short policy briefs. Casier and Moerenhout (2013) observed that the Appellate Body 'seemingly wanted to avoid ruling on whether an FIT constitutes a subsidy, thereby creating uncertainty for investors in renewables and governments designing their renewable energy policies.'¹² After exploring the findings on 'market creation' and 'benchmark markets', which we will delve with below, the main conclusion of the two authors is that the primary responsibility for clarifying the law is not of the Appellate Body, but of the WTO members. The way forward for the regulation of renewable energy support in the WTO is law reform, 'in the form of general exceptions or the revival and renegotiation of the expired non-actionable category of subsidies in Article 8'.¹³ In a similar vein, Cosbey and Rubini (2013) criticized the Appellate Body, highlighting in particular the implications of the decision for the future. If the Appellate Body gave more flexibility, this came with a hefty price, especially with respect to subsidy transparency and good governance. The uncertainties and dangers with which we are left after this ruling support, in the authors' view, the case for reform of subsidy rules. They note:

All this supports the case for reform of subsidy rules. As this case shows, a case-law solution has inherent limitations. Members – not dispute settlement – should take the lead and responsibility on identifying what is good policy and should therefore be permitted. Only reform, which may take various forms [interpretative understanding, authentic interpretation, temporary waiver, treaty amendment], all ultimately in the hands of Members, would enable to reach the objectives of desirable policy space, in respect of the integrity of the rules, and safeguard of transparency and good governance. Only reform can ensure the legitimacy of the fundamental decision of what type of government intervention should be permitted and what should not. Only reform can ensure the necessary legal certainty to both government and business action.¹⁴

In a second client briefing, Amar Breckenridge focused on, and criticized, the Appellate Body's market definition analysis.¹⁵

The first comprehensive academic commentaries appeared in the first quarter of 2014. In a lengthy, at times caustic, working paper, Rubini (2014a) produced an extensive critique to both the Panel's and the Appellate Body's decisions. He surveyed the various economic and legal errors of these rulings which, in his view, all boil down to an incorrect approach to legal analysis and are an excellent example of an unwarranted activist attitude where what are perceived as desirable policy outcomes seem to count more than correct legal interpretation.

¹⁰ Breckenridge (2013a), p. 4.

¹¹ It is interesting to speculate here whether, to an economist, the subsidy and benefit questions are really one and the same thing. In other words, we have the impression that in economic analysis the questions - 'Is it a subsidy?' 'Does it give a benefit?' - are different and do not necessarily require the same answer. As Sykes (2010) acutely notes, if it does not want to be 'myopic', the 'benefit' question inevitably looks at 'goals' and 'effects' of the policy. This means that the benefit analysis is particularly sophisticated. The case is different for the WTO lawyer: under Article 1 of the SCM Agreement, you cannot have a 'subsidy' without a 'benefit' and, arguably, the benefit test is much simpler than what an economist may perhaps think, being content with establishing a positive alteration of the *status quo ante* which has the potential of distorting trade. According to this logic, effects and objectives of the subsidy are assessed only afterwards.

¹² Casier and Moerenhout (2013), at p. 2.

¹³ Ibid, at p. 6.

¹⁴ Cosbey and Rubini (2013), at p. 11.

¹⁵ Breckenridge (2013b), at p. 4.

The first issue of 2014 of the Journal of International Economic Law features two articles on the case. Cosbey and Mavroidis (2014) provided a complete review of the Appellate Body decision. Their assessment is also negative, and the approach followed by the Appellate Body, aimed at avoiding finding that a scheme promoting a public good is a subsidy, is tagged ‘legal acrobatics’. In particular, they noted:

There are many problems with the approach followed: it is hardly reconcilable with the text and spirit of the relevant WTO rules; it might be giving WTO Members the wrong incentives by opening the door wide to industrial policy unlimited; it places squarely before us the question whether the WTO courts have behaved as agents called to apply a law decided by their principals, or whether they re-invented themselves as principals and decided what the law should be.¹⁶

Their conclusion is that the ‘rationale for subsidization should matter’ and that WTO subsidy laws should be re-thought accordingly.

Equally critical is the other article in the same issue of the JIEL. Pal (2014) complained about the Appellate Body’s interpretation of the benefit. In his view, this ‘exhibits a bias on the part of the Appellate Body to exempt government support for renewable electricity from the disciplines of the SCM Agreement’.¹⁷ This may result in giving the green light to trade-distorting subsidies for inefficient production technologies.¹⁸

Hestermeyer and Nielsen (2014) concentrate on the legal status of local-content requirements under WTO law. The authors also summarize and briefly comment on the Appellate Body’s subsidy analysis. If they do not openly criticize this jurisprudence, they however note the ‘liberty to establish “artificial” markets’ and the reference to policy imperatives which is now making considerably harder to establish a benefit.¹⁹

If virtually all commentary outlined so far is critical, one piece, appeared in the Journal of World Investment and Trade, is more on the positive side in its evaluation. While conceding that the Panel’s and Appellate Body’s approach may well be regarded as ‘activist’, Kent and Jha (2014) believe these rulings are better classed as ‘evolutive’. They note in particular that the two adjudicating bodies ‘had reasonable grounds to develop the law and adapt it to today’s circumstances, necessities, as well as to the overwhelming state practice’.²⁰ The two authors also noted important limitations to this approach, introduced by the Appellate Body itself, and in particular the strict prohibition of discrimination as well as the reference to the use of competitive bidding procedures.²¹

Time has enabled scholars to provide more theoretical analysis on this case too, which is evidence of the inspirational potential of its issues and findings.²² Importing concepts from sociology, Andrew Lang analyzes various subsidy cases, including *Canada – Renewable Energy/FIT*.²³ In his view,

[t]he point is crystal clear: what is happening in these and other examples is not the objective definition of a subsidy by reference to an idealized natural market; instead, there is the contingent claim that a certain kind of measure should (or should not) be treated *as if* it were a subsidy for present purposes, based on a particular understanding of the objectives of the Subsidies

¹⁶ Cosbey and Mavroidis (2014), at p. 31.

¹⁷ Pal (2014), at p. 125.

¹⁸ Ibid, at p. 136.

¹⁹ Hestermeyer and Nielsen (2014), at p. 588.

²⁰ Kent and Jha (2014), at p. 269.

²¹ Ibid, at p. 266.

²² See, eg, Bigdeli (2014) that mainly analyses the law and politics of the localization element of the FIT.

²³ Lang (2014).

Agreement, and the institutional role of WTO dispute settlement. The notion of subsidy, in other words, is only ever defined for a specific purpose and relative to a particular context.²⁴

The (so far) final piece commenting the *Canada – Renewable Energy/FIT* disputes is that of Charnovitz and Fischer (2014). The authors highlight the apparent shift indicated by the Appellate Body's analysis from the 'primacy of the market' to the 'primacy of government volitions'. They also note that, before this case,

the conventional wisdom was that Ontario's FIT program (like many FIT programs) purchases electricity at above-market prices. [reference omitted.] The Appellate Body, in effect, moved the goalpost by redefining the market to be electricity from renewable sources. As a result, the question of whether the prices paid in the FITs are above market no longer has an obvious answer.

Most crucially, while, courtesy of the special characteristics of renewable energy, Charnovitz and Fischer (2014) do not necessarily reject the 'selection of a renewable energy electricity market as the relevant market for determining whether the benefit exists', they are concerned for the 'lack of cogency' in the conclusion that supply-side factors outweigh demand factors, and, more generally, for the lack of methodology on how to compare the relative weights of these factors. Their main apprehension is formulated as follows:

in our view, it is disturbing to think that whatever government policies emerge from public choice distortions are automatically mapped into the baseline in determining whether a recipient of a financial contribution is better off than it would have been in the marketplace. Besides preferences about diversification in electrical generation, governments may have preferences about the merits of state-owned enterprises, the benefits of technological localization, the value of export-led manufacturing, the recalibrating of transatlantic income tax symmetry, or redistributing income from other countries. Nor does the ruling seem to restrict itself to the arguably unique case of electricity markets.

The Appellate Body does not seem to recognize the slippery slope it has created by introducing policy considerations into the determination of benefit (in seeming contradiction to its own case-law) and by equating politician preferences with consumer preferences. [footnote omitted] Perhaps the Appellate Body should have given more attention to the dissenting jurist's warning that the fact that a market does not meet the objectives that a government might have does not shield financial contributions from benefit analysis. [footnote omitted]

In conclusion, we consider it highly significant that (with a couple of exceptions) virtually all commentary so far is highly critical of the benefit analysis of the Panel (majority) and the Appellate Body. *Vox populi, vox dei!* – we would be tempted into adding.

After this literature survey, it may now be useful to briefly review the two innovations introduced by the Appellate Body – and explain why they amount to serious misconstruction of the benefit and of subsidy laws at large.

²⁴ Ibid, at p. 21. We take the liberty of briefly commenting on this important claim (in this elegant paper). Clearly, there are many uncertainties in the (legal) notion of subsidy which is ultimately a (legal and) positive construct. Admittedly, there is also often a significant amount of leeway in interpreting the law and thus concluding that one given measure is (or is not) a subsidy. Many 'contextual' circumstances, such as the purpose of subsidy control and – within it – of the definition of subsidy, certainly matter in this exercise. We are not, however, at ease with an approach, or at least a heuristic, that, if our understanding is correct, seems to essentially consider the act of defining as inherently flexible and relative, which changes depending on the interpreter, the case or indeed the circumstances. Following the example above, the act of identifying the purpose or purposes of subsidy laws cannot be started from scratch every time. Most importantly, it cannot change depending on the persuasions of the individual interpreter. The WTO subsidy system – if it wants to be such – must aim for unity, coherency and consistency. Changes in interpretation can happen, but must be warranted, transparent and fully justified. These brief notes, we hope, elucidate our recurring statement about the importance of teleology for understanding subsidy laws in general and the role and meaning of the definition of subsidy in particular.

3. First mistake: the definition of the market

It is common ground in WTO subsidy laws that the benefit determination requires the identification of an appropriate market benchmark against which the measure at issue should be assessed.²⁵ In the *Canada – Renewable Energy/FIT* case, the Appellate Body immediately made it clear that, in order to identify an appropriate market benchmark, it is first necessary to define the relevant market.²⁶

Market definition is a prevailing tool of antitrust analysis, preliminary and functional to the assessment of market power, where its goal is to assess whether the firm under investigation is subject to competitive constraints. This is done through enquiring whether the products or services at issue are substitutable with each other. The Appellate Body's approach and jargon seem to directly refer to this antitrust world.

What is crucial is that, according to the Appellate Body, the definition of the relevant product market in the context of the benefit analysis, cannot stop at the demand-side but should also consider the supply-side.²⁷ This way of proceedings has momentous consequences (which will be explained later on). For now, we concentrate on whether this methodological approach is correct or not.

The key criterion of assessment of the Appellate Body's methodology is whether the nature of subsidies, and the specific goal of the benefit test, allow this antitrust import.

We argue that the Appellate Body is wrong because it makes a too-easy transplant from market definition in antitrust analysis to subsidy analysis. Subsidies pose different problems as compared to collusive or anti-competitive unilateral conduct. As a direct consequence of this, product market definition for subsidies is different.

To explain this point, it may be useful to make reference to the EU experience where competition laws encompass typical antitrust laws (regulating collusion and abuses of dominance), merger control as well as State aid control. Market definition is a very common and entrenched tool of analysis. The 1997 Notice on the definition of the relevant market for the purposes of Community competition law of the EU Commission makes an express distinction between market definition in antitrust and market definition in State aid.²⁸ We can read

The focus of assessment in State aid cases is the aid recipient and the industry/sector concerned rather than identification of the competitive constraints faced by the aid recipient.

This concept is expressed even more clearly in a study carried out by two economists and ordered by the EU Commission in the mid-2000s. Nitsche and Heidhues (2005) note:

Market definition in the context of State aid should focus only on demand side substitutability. This is in contrast to the standard competition policy approach where both supply and demand substitutability are considered. In standard competition policy cases, the focus is on the competitive constraints that make price increases unprofitable. For this question, it is important to include those potential competitors that render a price increase unprofitable because they have an incentive to start producing substitute products once the price is raised. In State aid cases, the relevant question is to trace the effects of a price decrease or an output expansion of the aid recipient's products. Thus, market definition should focus on how other existing producers are affected and on the potential effects on producers in markets that the aid recipient intends to enter.²⁹

²⁵ Appellate Body, *Canada – Aircraft*, para. 149.

²⁶ Appellate Body, *Canada – Renewable Energy/FIT*, para. 5.169.

²⁷ The immediate – but inappropriate – precedent referred to by the Appellate Body is its decision in the *EC – Aircraft* dispute where the analysis focused on the 'serious prejudice' requirement. See Cosbey and Mavroidis (2014), at p. 26, Pal (2014), at pp. 22-23.

²⁸ European Commission (1997), at p. 5.

²⁹ Nitsche and Heidhues (2005), at pp. 121-122.

It is worth noting that these observations are not system-specific, ie they are not valid only in the specific context of the EU and its State aid control. They are 'economics 101'.³⁰ Subsidy control is not antitrust. Supply-side analysis is largely irrelevant.

If the above is correct, it is clear that, by considering supply-side in its product market definition, the Appellate Body has made a fundamental mistake of economic methodology which, being imported into and relevant to legal analysis, turns into a fundamental mistake in the legal analysis.³¹

We do not therefore share Charnovitz and Fischer (2014)'s view that the Appellate Body may have been correct in *concluding* that renewable energy is a market on its own, and that the main issue with their decision is in the lack of reasoning – better: of methodology – justifying that conclusion. Surely, as they note, 'government renewable energy policies do not view all electricity generation as the same'. This does not mean, however, that they necessarily belong to a different market. The fact itself that support to clean energy may harm conventional energy producers is evidence of the fact that what we have is one single market.³² What we are trying to say is that there is no (full) overlap between policies and markets.

What are now the momentous consequences of the Appellate Body's wrong approach?

In this case, the Appellate Body considered the different costs structures and operating costs and characteristics of renewable energy production, vis-à-vis other electricity, as relevant supply-side consideration. This led the Appellate Body to conclude that the relevant market is only that of electricity produced by wind and solar (as opposed to the broader energy market).³³

The result of the Appellate Body's narrow market definition was that the appropriate available benchmarks became those of renewable energy sector and its characteristics. In a sense, the economic and legal standard against which Ontario's FIT had to be judged was essentially 'tailored' to that same policy. In other words, the Appellate Body's move – our set of reference is renewable energy only – made it easier for Ontario's policy to become the *norm*, or close to the norm, and thus reduced the possibility that it could be regarded as exceptional and hence advantageous. (And the reader should recall – this practically means a 'no benefit' and hence 'no subsidy' finding.)

Had the AB applied market definition correctly, they would have concluded that the market was broad, encompassing all electricity, irrespective of its green or less green origin. This would have paved the way to the easy conclusion that there was a benefit *and* a subsidy. In sum – an outcome *opposite* to the one reached by the World Trade court.

In conclusion, the first innovation of the Appellate Body has been to request a full market analysis at the level of the benefit analysis and, most importantly, to indulge in considering supply-side. This has led to the narrowing of the market and of the universe of reference for benchmark identification.

4. Second mistake: the creation of the market

After having defined the relevant market in a narrow way, the Appellate Body carried out its analysis and introduces another important innovation. They said it is necessary to distinguish new markets from existing markets. In particular, in an already oft-quoted passage, we can read:

³⁰ The quote from Nitsche and Heidhues (2005) is the distillation of a literature review on the issue.

³¹ For further analysis see Rubini (2014a) and (2014b).

³² This effect – which is basic economics – is recognized by Charnovitz and Fischer themselves.

³³ We do not touch here on whether, even assuming the correctness of considering supply-side, the Appellate Body has identified the right factors. In fact the Appellate Body's execution of supply-side analysis is at best cursory. See Cosbey and Rubini (2013) at p. 8; Rubini (2014a), at p. 14 and (2014b), at pp. 913-914; Cosbey and Mavroidis (2014), at p. 27.

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.³⁴

This distinction is puzzling.³⁵ Unfortunately, however, the distinction between new, indeed *created* markets, and existing markets has crucial practical significance. The Appellate Body is in particular saying that the acts that lead to the creation of new markets do not ‘amount in and of itself to a subsidy’.³⁶ To paraphrase – they are not saying that market creation does never amount to a subsidy but that this does not automatically happen. You need to have other factors or circumstances present that may turn this act of creation into a subsidy problem. Absent them, the Appellate Body is crucially suggesting, you do not have a subsidy. As has been repeatedly said, this is a ‘carve-out’, ‘exception’ or ‘exclusion’ of certain types of action from subsidy laws.

The attentive reader may have started to ask questions: how does one identify a new market? What does creation of a market mean, from a prescriptive and legal perspective (which is the one that matter in the current context)? What can turn a ‘no-subsidy scenario’ into a ‘subsidy scenario’? Where, and how, do you draw the line?

Let’s carry on with the analysis of the indicia left by the Appellate Body. They do indeed provide various indications of what the act of market creation may involve: governments decisions on the supply-mix of energy (which does depend on policy choices and objectives),³⁷ the regulation of the quantity and type of electricity supplied through the network and the timing of supply,³⁸ what are called the parameters of the system,³⁹ price setting, such as FITs (based on cost-recovery and a reasonable margin), and quantity mandates.⁴⁰ If this is what the market creation scenario includes, it is clear that this is a broad notion.

Does all this mean that all types of activity included in the previous list are sheltered from the wrath of subsidy disciplines? It seems not. If we focus on the measure at issue in the *Canada – Renewable Energy/FIT* case, it looks like a FIT may be protected if its key economic component – the tariff - is adequate and not excessive. But the identification of the dividing line between what is adequate and what is excessive may be difficult. A new set of questions naturally arises. In particular: How do we define the appropriate level of costs and profit? Is the Appellate Body providing a shelter for the compensation of all costs of renewable energy production? Or – rather – should the safe-harbour be recognized only for the extra or additional costs for producing clean energy? Shall we really – as the Appellate Body suggests – limit our search to the clean energy sector only? Or – rather – should our analysis consider the costs and profits of producing energy or electricity more generally? These are crucial questions which ultimately lead to the identification of the standard against which the measure at issue needs to be scrutinized. We will return to this below.

³⁴ Appellate Body report, para 5.188 (emphasis in the original).

³⁵ See Charnovitz and Fischer (2014).

³⁶ 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. As Charnovitz and Fischer (2014) aptly note, the Appellate Body does not offer any justification for this momentous statement.

³⁷ Appellate Body Report, paras. 5.175, 5.190, 5.227.

³⁸ Appellate Body Report, para. 5.185.

³⁹ Appellate Body Report, para. 5.189.

⁴⁰ Appellate Body Report, para. 5.175.

Let's now pause a bit and discuss the several innovations introduced by the Appellate Body. We explained elsewhere our serious misgivings about the Appellate Body's notion of 'market creation'.⁴¹

This is, in our view, faulty in three fundamental respects.

First, it is wrong inasmuch as it does *not* have any *legal* or *economic justification*. From a legal standpoint, it is, in essence, an example of unwarranted consideration of public policy objectives at the level of the definition.⁴² This takes place by making governmental energy supply-mix decision relevant. From an economic view point, a paradox comes out. To say that if you create a market from scratch you may be safe under subsidy laws – as opposed to less significant interventions in the market – can be rephrased in the following way. The bigger the market failure, the action of the government, and the possible distortions, the less likely you are found - *legally speaking* - to confer a subsidy. Can this be right?

Secondly, the boundaries of the 'market creation' scenario – which, it is important to remember, does not have a purely descriptive function but aims to represent a prescriptive legal notion, capable of distinguishing what does amount (or otherwise) to a subsidy, are ultimately *undefined* and *unclear*. To put it differently, can we simply rely on the adequacy or excessiveness of remuneration? We are not persuaded into believing that the benefit and subsidy question is just a matter of proportionality of public action. Surely, the question is different. Would market forces alone have acted as the government has acted?

Thirdly and finally, as it has been formulated, the language of market creation, is dangerously *open-ended*. Considering its important practical effect (ie carve-out of certain measures from subsidy control), more precision (and arguably strictness) is necessary.

As noted, the Appellate Body also gives some indications about what type of benchmarks could be of use in discriminating creations from interventions. As Charnovitz and Fischer (2014) note, the Appellate Body suggests a (not-so-rigid) sequence of benchmarks.⁴³ In particular, there seems to be two different kinds of yardsticks. The first category seems to a large extent to rehearse the *acquis* on the issue, referring to market prices, administered prices and proxies. As it is also common practice, the possibility for construction or adjustment is expressly mentioned. At this point, there is, however, an interesting twist in the analysis, which may indeed constitute an important hint, and an indication of what lies ahead in the future of benchmarking. After outlining the various benchmarks outlined above, the report reads:

Alternatively, such benchmark may also be found in price-discovery mechanisms such as competitive bidding or negotiated prices, which ensure that the price paid by the government is the **lowest possible price** offered by a willing supply contractor.⁴⁴

What is the meaning of 'alternatively' (in particular if read together with the adverb 'also')?⁴⁵ Is it closer to 'available as another choice', essentially suggesting price-discovery mechanisms as one of the various alternatives? Or does it rather mean 'in the absence thereof', which would, by contrast, suggest a stricter subsidiarity of the use of these procedures to the more prevailing practice of discovering benchmarks from the market? These questions have fundamental practical importance.

⁴¹ See Rubini (2014a), at pp. 15-17, and (2014b), at pp. 914-916, for full analysis.

⁴² With another jargon, what we have is the confusion of the question of the existence of the subsidy with that of its justification.

⁴³ Appellate Body report, paras. 5.227 and 5.228.

⁴⁴ Appellate Body report, para. para 5.228. There are also other references to 'price-discovery mechanisms' in the decision. See para. 5.225 ('... the market based, price-discovery mechanism ...'), para. 5.233 ('competitive bidding, which is a market-based, price-discovery process ...'), and para. 5.243 ('... price-discovery mechanism, which was based on ... competitive bidding.').

⁴⁵ We, of course, use the Oxford English Dictionary in our linguistic analysis.

What did the Appellate Body mean to say? Are they hinting at something, indicating in particular a preference for these benchmarks which, as they show to believe, ‘ensure that the price paid by the government is the lowest possible price offered by a willing supply contractor’? To put it another way, do now governments - in order to be on the safe side - have an incentive to use price-driving mechanisms? We do indeed believe this is the case. As the following section tries to show, there may other contextual indications to support this reading.

Now, although the use of price-driving mechanisms does not necessarily exclude the existence of a subsidy,⁴⁶ it may be a useful path to follow to ensure that a) the remuneration is the minimum necessary (thus keeping distortions to the minimum, if not avoiding them), and b) the awarding government acts in a transparent way (which would contribute to avoid abuse and circumvention). This concept is thoroughly analyzed in the following sections.

We conclude our analysis of the two innovations on the benefit analysis of the Appellate Body with one gloss. The two innovations of the Appellate Body – a narrow market definition and the idea that new markets are to some extent beyond subsidy laws scrutiny - are two sides of the same coin. They share the belief that renewable energy is ‘special’ and that, for this reason action to support it cannot be considered as exceptional or derogating (which is the essence of the legal notion of subsidy).⁴⁷

5. The real victory of the EU

We have noted our impression that the Appellate Body seems to be hinting at a preference for ‘price-discovery mechanisms such as competitive bidding or negotiated price’.

But where does this type of benchmarks come from? Who did mention or put forward them during the litigation? The reference to public procurement procedures as devices to exclude that financial contributions confer undue advantages will certainly ring a bell with any reader with some knowledge of EU State aid law. One of the most prominent debates in the State aid world in the beginning of the 2000s was the legal status of the financing of public services.⁴⁸ In particular, the question was whether the simple compensation of their costs can confer an economic advantage and hence qualify as State aid. After a fluctuations in the jurisprudence, which featured an interesting clash of views,⁴⁹ the European Court of Justice (‘ECJ’) passed the famous *Altmark* decision in 2003. The ECJ conclude that there is no advantage (and no State aid) if four conditions are satisfied, notably:

- first, the recipient undertaking is actually required to discharge public service obligations and those obligations have been clearly defined;
- second, the parameters on the basis of which the compensation is calculated have been established beforehand in an objective and transparent manner;
- third, the compensation does not exceed what is necessary to cover all or part of the costs incurred in discharging the public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations;
- fourth, where the undertaking which is to discharge public service obligations is not chosen in a public procurement procedure, the level of compensation needed has been determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.

⁴⁶ We will delve on this nodal point later on (see section 8).

⁴⁷ Rubini (2009) at chapter 7.

⁴⁸ ‘Services of general economic interest’ in the EU jargon.

⁴⁹ For a discussion see Biondi and Rubini (2005).

To rephrase and distill the key legal issues, under the *Altmark* jurisprudence, there is no aid, from a legal standpoint,⁵⁰ if i) there is a clear entrustment of public service, ii) the compensation is defined beforehand and in a clear and transparent manner, iii) the compensation is necessary, and iv) the enterprise is chosen via public procurement procedures or, in the absence of this, the compensation is the one that a 'typical undertaking' in sector/with those tasks would incur. All these conditions need to be cumulatively present in order to make the measure of support safe under EU State aid law.⁵¹ If any of them is not present, the 'subsidy' will qualify as 'State aid', will be subject to notification requirements. If the conditions of the relevant exceptions are there, it may eventually be declared legal, that is 'compatible with the internal market' in the EU language.

This case and its test were clearly on the mind of EU litigators who clearly tailored some of their legal arguments to the *Altmark* jurisprudence.⁵²

This enables us to make a step further. The real winner of the *Canada – Renewable Energy/FIT* case is the EU – and not only in the superficial sense of having obtained its litigation goal, ie the condemnation of Ontario FIT programme's local content requirement. In this sense, the EU is a winner as much as Japan, the other complainant.

The EU's success is much deeper and can have broader implications. It is based on canny strategic lawyering which has secured that one interpretation of the benefit, which is prevailing and on the rise in domestic EU law, be accepted by the Appellate Body and, if followed and built upon in future cases, may crucially render a broad range of EU-law-compatible aid measures secure under WTO law as well.⁵³

The requirement of price-discovery mechanisms is now pervasive in domestic EU State aid law⁵⁴ and will soon become the only alternative for renewable energy support. For example, according to the new Energy and Environmental Aid Guidelines, introduced on 9 April 2014,⁵⁵ with the possible

⁵⁰ The case may be different from an economic viewpoint that may still consider the compensation a subsidy. It is telling, in this respect, to note that the ECJ itself, in the chapeau preceding its four conditions, noted: 'public subsidies intended to enable the operation of urban, suburban or regional scheduled transport services are not caught by that provision where such subsidies are to be regarded as compensation for the services provided by the recipient undertakings in order to discharge public service obligations.' In other words, these subsidies are still subsidies but are not caught by the legal definition if the said requirements or proportionality and transparency are satisfied. In a nutshell, this shows the political nature of the *Altmark* decision. Put between two extreme interpretations (compensation of public service costs is never / always aid), and faced with the need to reduce the potential workload of the Commission (it bears repeating that in the EU there is a duty for all Member States to notify all plans of aid in advance to the Commission for its approval), the Court came with a Solomon's decision.

⁵¹ Interestingly, the Commission, in its case-by-case scrutiny of notified plan of aid has hardly found them satisfied.

⁵² See, eg, European Union's closing oral statement at the second meeting with the Panel, para. 11 ('In those situations, where the State is in a monopsony position, the State can obtain the lowest possible price from each producer through direct negotiation or through a bidding process that will ensure purchases at no more than the specific costs plus profit expectation by each bidder.'), and European Union's Final Oral Statement before AB, para 33, for a similar, almost verbatim, statement. See also the Other Appellant Submission by the European Union, where the reference to the use of bidding processes as devices good to exclude the benefit is pervasive.

⁵³ On the contribution of the EU to rule development in WTO litigation see Krueger (2014). For a discussion on the (missed and taken) opportunities for strategic lawyering in the WTO see Santos (2013).

⁵⁴ There are essentially two levels where public procurement can become relevant in State aid control. First, when it comes to decide whether the measure confers an advantage and an aid (which is what is discussed in *Canada – Renewable Energy/FIT*). Secondly, after a measure has been qualified as aid, when it is necessary to determine whether it is still justifiable because it is achieving a legitimate goal as provided under relevant EU State aid law.

⁵⁵ European Commission (2014a). 'Competitive bidding processes', under Article 1.3 (43) of the Guidelines, means 'a non-discriminatory bidding process that provides for the participation of a sufficient number of undertakings and where the aid is granted on the basis of either the initial bid submitted by the bidder or a clearing price. In addition, the budget or volume related to the bidding process is a binding constrain leading a situation where not all bidders can receive aid.' It is important to note that the guidelines apply to those measures that already qualify as State aid and that, if they satisfy the

exception of small producers (ie small installations or technologies), feed-in tariffs are progressively replaced by ‘competitive bidding processes’ which, in the EU’s view, ‘will increase cost effectiveness and limit distortions of competition’.⁵⁶ In other words, the use of competitive bidding is a legal requirement for Member States to have their renewable energy subsidies compatible with EU law. In Europe it will in principle become the norm in 2017.⁵⁷

We will go back to *Altmark* and its four conditions as source of inspiration for techniques to clarify-and-narrow the ‘*Canada – Renewable Energy* exception’. We will also crucially outline the challenges faced in the EU in making use of public procurement procedures to exclude the existence of State aid.

6. The wide road

As noted, the innovative approach introduced by the Appellate Body probably raises more questions than giving answers. Generally speaking, two broad approaches to the ruling and its reasoning are now possible, one broad, the other narrow. In this section we focus on the former, leaving the analysis of the latter to the next section.

Future WTO panels (and indeed the Appellate Body) could follow the ‘wide road’. The premise of this approach is that the *Canada – Renewable Energy/FIT* decision is good law, inasmuch as it offers a proper interpretation of the benefit. Crucial to this stance is that the ruling does in no way create a carve-out or exception. In a nutshell, the adoption of this approach is premised on the ‘normalization’ or ‘justification’ of the decision.

There are indeed two possible variations to this view. On the one hand, one could argue that the decision is about creating a shelter for renewable energy sector, in the absence of specific exceptions. Additionally, it could be observed that it is the specific factual and economic circumstances of the case that make this law very case-specific and the possibility of exporting it extremely difficult. If this is the case, the argument goes, there would simply be no need, or indeed possibility, to refer to this ruling in future cases. This does not exclude, however, that, in practice, it is highly likely that future complainants, if necessary, will base their claims and arguments on this ruling and its reasoning, forcing adjudicating bodies to difficult distinguishing exercises. Hence, the benefit findings of the *Canada – Renewable Energy/FIT* case could have – *de facto* - broader application, beyond this case and this sector.

On the other hand, even more dangerous than a simple normalization of the ruling is its express ‘generalization’ or ‘expansion’. In other words, the main concern and risk is that this law is intentionally interpreted and applied broadly. The logical fabric of the reasoning of the Appellate Body would be considered as a good prototype to replicate and use in other cases.

(Contd.) _____

conditions of the guidelines, may nonetheless be considered as permitted, in the EU State aid jargon ‘compatible with the internal market’.

⁵⁶ European Commission (2014b), at p. 2. One can read that ‘[f]rom 2016, generators need to sell their electricity in the market and be subject to balancing responsibilities (an obligation on producers to compensate for short-term deviations from their previous delivery commitments). As of then, Member States are also obliged to use as support instruments market premiums – a top-up on the market price – or certificates in order to promote the better integration of renewable energy into the market. In 2015-2016, Member States will start implementing competitive bidding procedures for a small share [at least 5%; see para. 127] of their new capacity for renewables. From 2017 on, Member States shall set up tenders to grant support to all new installations’ (emphasis added).

⁵⁷ As noted, small producers can be exempted. Equally, Member States can depart from competitive bidding when the outcome might not be optimal, for example because of the very limited number of projects or sites that would be eligible, or because competitive bidding may lead to higher support levels (for example due to strategic bidding) or would result in low project realization rates. See European Commission (2014b), at p. 2.

These scenarios are not mere speculation. Prominent players have already taken positions very close to the ones just depicted.⁵⁸ The arguments are various: the ruling could hardly apply beyond the specific circumstances of the case; the Appellate Body approach would simply reflect a 'widespread technique for concluding that there is no aid or subsidy', one reflecting a *quid pro quo* analysis whereby the alleged benefit of the measure is simply compensating a cost, disadvantage or obligation on part of the recipient; there is no issue (and 'no benefit') if the measure is not discriminatory and pursues a legitimate objective in a proportional way; the use of 'price-discovery mechanisms' does ensure that there is no over-compensation; ultimately, the decision, and in particular the distinction between market creation and market interventions, simply reflects the distinction between regulation and subsidies: the lack of application of subsidy laws does not imply a legislative vacuum but more simply that other provisions, such as national treatment ones, would find space.

We are not persuaded by these arguments. First, the innovative findings of the Appellate Body, and in particular their 'market creation carve-out', are sufficiently broad, and unclear, to find application in many other cases, beyond the clean energy sector, and beyond this case. The variety of real life and litigators' ingenuity will offer context. Secondly, the *quid pro quo* approach, imported from EU State aid law, is not widespread at all, quite the contrary. We will return this point. Most importantly, irrespective of its general or otherwise currency, the adoption of a broad 'compensation logic' when it comes to define a measure as subsidy brings with it the risk that a (net) benefit will rarely be found to exist. Thirdly, to simply rely on whether the measure does (not) discriminate⁵⁹ or on whether there is a proportion in relation to a legitimate objective leads to the same type of inconvenience. It is conceptually vague and practically dangerous. Fourthly, the use of price-discovery mechanisms does not necessarily ensure that there is no over-compensation. It all depends on whether what the public body wants and is prepared to pay is in line with what the market wants and would be prepared to pay. In other words, the use of price-discovery mechanisms cannot replace the validity of the indications coming from market benchmarks. We will come back to this crucial aspect below. Finally, the distinction between regulation and subsidies cannot be found in the law. It is a rationalization that is probably more useful to describe an outcome rather than crucially offering indications on what is or is not covered by the definition of subsidy. Furthermore, even assuming its correctness, there is a very large grey area in the middle. The measures subject to analysis in cases like *Canada – Renewable Energy/FIT* or, in the EU, *PreussenElektra* are excellent examples to the point.

In conclusion, an expansionist reading of the Appellate Body's analysis can give a huge blow to subsidy disciplines, lessening transparency and control of potentially trade-distorting measures.

As Matthew warns, 'broad is the road that leads to destruction, and [unfortunately, we add] many enter through it.' This can be aptly applied to our case too.

7. The narrow road

If there is a wide road, there is also a narrow one. The premise stands in contrast with the assumption of the alternative approach. Stake-holders, litigators, and especially adjudicators, must at least be aware (if not even recognize) that *Canada – Renewable Energy/FIT* has created a carve-out for certain subsidies and that its reasoning and conclusions are in various respects 'exceptional' (or, more bluntly, incorrect).

With this premise, clearly the first-best scenario would be to simply ignore this ruling. It was a case-specific solution to a case-specific problem. The argument, mentioned above, whereby the decision would be justified by various peculiar facts and circumstances, leads in the same direction.

⁵⁸ If our understanding is correct, this is in essence the view of James Flett, one of the leading EU litigators, that, speaking in his personal capacity at public conferences in Florence and London, has forcefully expressed similar views.

⁵⁹ One is tempted into asking: how many subsidies can really be non-discriminatory, even de facto?

We believe this is unlikely. As suggested, it is rather highly likely that this decision, which has become one of the key rulings in WTO subsidy law, will be relied on. The ruling and its analysis will provide ammunition to those that will consider them favourable to their litigation and strategic position.

It must mean something that virtually all commentators that have criticized the Appellate Body decision have also called for its clarification-and-narrowing. After noting that the ruling may open the way to trade-distorting subsidies for inefficient production technologies, Pal (2014) concludes with an important gloss: '[t]he Appellate Body may therefore find itself in a position in the future where it needs to rein in its holdings in these disputes'.⁶⁰ Cosbey and Mavroidis (2014) equally highlight the risk that the rulings 'open the door to industrial policy unlimited' and accordingly call for the need to impose some limits to the Appellate Body's findings, especially those concerning the creation of the market scenario.⁶¹ In the same vein, Cosbey and Rubini (2013) hint at the need for the Appellate Body to impose 'rigorous conditions' on the shelter it has created.⁶² Rubini notes that it is important that the flexibility granted by the Appellate Body is not abused. Hence, '[t]o avoid undue distortions, we also need to keep compensation at the minimum level necessary to achieve the goal'.⁶³ In practical terms, this would mean imposing conditions of transparency, proportionality, and also the use of bidding procedures.⁶⁴

If a clarification-and-narrowing seems to be highly desirable, we can now elaborate on what this could mean. The reader needs to keep in mind the various uncertainties left open by the Appellate Body (as discussed in sections 3 and 4).

Most of – if not all - the attention about clarifying – and – narrowing in the commentary so far has focused on the market creation carve-out. There is a good reason for this. The consideration of supply-side in subsidy market definition is simply wrong, and, as such, it looks extremely difficult to advance adjustments that could make this option 'less wrong'. The only, minor, piece of advice we could give is: 'if you want to do it, then do it properly!'⁶⁵ This inevitably means that, for the reasons outlined above, supply-side considerations are irrelevant when it comes to define the relevant market in a subsidy scenario.

It is indeed with respect to the creation of the market carve-out that there seems to be more scope for clarification-and-tightening. On the one hand, we should seek a clear and firm definition of the circumstances and conditions that would allow governments, business and adjudicators to identify a scenario of market creation. On the other hand, clear conditions ensuring the proportionality and transparency of the transfer of economic resources should be introduced.

We delve into the details, and challenges, of possible improvements in the law in the next section.

⁶⁰ Pal (2014), at p. 136.

⁶¹ Cosbey and Mavroidis (2014), 29.

⁶² Cosbey and Rubini (2014), at p. 11.

⁶³ Rubini (2014a), at pp. 17-18, and (2014b), at pp.917-918.

⁶⁴ Rubini (2014a), at p. 18, and (2014b), at p. 918.

⁶⁵ For a criticism of the execution of supply-side analysis in the case see Rubini (2014a), at pp. 14-15 and (2014b), at pp. 913-914.

8. 'Many will try to enter and will not be able to': Will the Appellate Body find the narrow gate?

Matthew told us that many follow the wide road. In the corresponding passage of Luke's gospel, we find a complementary statement: 'Make every effort to enter through the narrow door, because many, I tell you, will try to enter and will not be able to.'⁶⁶

The key question for us (and for this section) is whether the Panels and, especially, the Appellate Body will find the 'narrow gate' and thus step the narrow road.

It is interesting to speculate whether the formulation of the *Altmark* conditions, and the EU experience in their application, can offer some guidance. Let's repeat them again. Under EU law, there is no aid if: i) there is a clear entrustment of public service, ii) the compensation is defined beforehand and in a clear and transparent manner, iii) the compensation is necessary, and iv) the enterprise is chosen via public procurement procedures or, in the absence of this, the compensation is the one that a 'typical undertaking' in sector/with those tasks would incur.

We now review each of these conditions and consider what lessons they could give to the WTO.

It is worth immediately highlighting to the non-EU lawyer that the *Altmark* decision, passed in 2003 after much controversy and fluctuations in the previous case-law, has generated much debate and two reform processes with extensive public consultations. The Commission, in the effort of clarifying this important decision, which drew a new line between aid and non-aid, embarked in a first reform in 2005⁶⁷ and, more recently, a second one in 2011.⁶⁸ It adopted various soft-law instruments which *inter alia* attempt to clarify the impact of *Altmark*. One of the crucial areas of contention has been the fourth condition, and in particular the criteria for the selection of the provider.⁶⁹

This very brief account of the complexity of the debate on the relationship between state aid control and the use of public procurement wants to pinpoint one simple fact. Far from being a panacea, the Appellate Body's reference to 'price-driving mechanisms' may – inevitably – have opened Pandora's box. The goal of this article is merely to highlight some of the issues that may come out and not to provide a comprehensive account of what in Europe has become a significant body of the law.⁷⁰ The big question now is whether the necessary clarification can be left to future judicial decision-making and to its inherently piece-meal and erratic nature, or whether more comprehensive and legitimate law-making processes should further define and clarify the law in this respect.⁷¹

The first *Altmark* condition refers to a clearly defined scenario: the recipient firm must have been entrusted with a public service obligation which justifies the compensation of the relative costs out of public purse. This entrustment does not need to be formal but it certainly needs to be express, what

⁶⁶ Luke 13:24.

⁶⁷ European Commission (2005a), (2005b) and (2005c).

⁶⁸ The 'Almunia Package' includes the European Commission (2012a), (2012b), (2012c) and (2012d).

⁶⁹ For a more detailed account of this long path of reform, the reader can consult the proceedings of the conference 'The Reform of State Aid Rules on Services of General Economic Interest' – From the 2005 Monti-Kroes Package to the 2011 Almunia Reform' which took place on 30 September 2012 at the College of Europe in Bruges. See the special issue of European State aid Law Quarterly (2/2012).

⁷⁰ A more detailed analysis is left to future ventures, should the WTO adjudicatory bodies decide to follow the path hinted at in *Canada – Renewable Energy/FIT*.

⁷¹ It is interesting to note in this respect that, in the EU, the judicial statements with respect to the use of public procurement procedures in the context of the State aid definition are extremely meager (apart from the landmark 2003 *Altmark* ruling of the European Court of Justice, we can only think of a handful of General Court's decisions). After that, the difficult, and long (8 years!), process of clarification of the law was carried out by an administrative body (the EU Commission) through an open and structured legislative process.

matters is the content of the act and not its form.⁷² This is the first and main condition which makes the relevance of *Altmark* and its *quid pro quo* approach unique and, to a large extent, exceptional. In other words, *Altmark* is not a general test for any type of payment of public money to firms. It only applies for the compensation of public service obligations costs to firms that are specifically entrusted. In other words, *Altmark* has always been perceived as exception, not the norm, in EU State aid law. Since it results in removing measures from State aid control, it has been subject to a careful and restrictive interpretation.

Most importantly for our analysis, the condition of entrustment is not generally subject to great contention, or, in any case, any question arising out of it can be clearly and satisfactorily answered in the ordinary process of clarification of the law. If we now move to the WTO, it is clear that the definition of the 'market creation' scenario, which should provide a clear and limited scope to the Appellate Body's carve-out, is far more difficult. Admittedly, we are at a loss if we try to think at how this scenario could be better defined and formulated having in mind the need to guide the behavior of governments and businesses.

The second condition, which codifies the requirements of good administration and transparency, should arguably be inherent in the reference to price-discovery mechanisms, and, more generally, in any test that wants to ensure that no benefit is given. It is also arguably of paramount importance also for another, crucial reason.

All the tests we are discussing are about drawing the line between what is and what is not a subsidy. As noted, there are important consequences in terms of transparency and governance depending on the subsidy qualification. Only if you have a benefit – and hence a subsidy – you need to notify the measure to the WTO. If there is no benefit, there cannot be any subsidy under the SCM Agreement, and consequently there is no notification duty. It is therefore clear that to request that the procedure that may lead to exclude the existence of an economic advantage be transparent would also partly serve – although in a different way - the pervasive need for transparency in subsidy control.⁷³

The third condition (necessity) corresponds to the main thrust of the Appellate Body decision in *Canada – Renewable Energy/FIT*. It, however, refers to a very ambiguous concept.

To say that something needs to be necessary does not say much and leaves a lot - too much - unspecified. In particular, the necessity determination turns on the two terms of the relationship. What costs should be covered? Using the example of energy: any cost of energy production? Or – rather - only the additional costs to generate renewable energy (ie those costs that are extra as compared to conventional energy production)? Can the compensation cover every cost that is indicated in the bids, or only the costs of the most efficient firms in that sector? More fundamentally, what should the compensation be necessary for? To acquire energy or electricity? Or to buy *green* energy or electricity? Or even to purchase supply green energy by using a *certain green technology*? These questions touch the fundamental problem. From a subsidy perspective, price-driving mechanisms can really exclude any benefit only if public policy considerations are expunged from the procurement process to completely align the contracting body's action with that of any other private agent in the market. We will go back again to this fundamental assertion.

⁷² Gerardin (2012) at p. 53.

⁷³ Transparency is important in the EU system of State aid control too. The whole enforcement of the rules, which is based a preventive and central control exercised by the EU Commission in Brussels, is fundamentally premised on Member States' notification. It is therefore interesting to note that, in the context of the *Altmark* jurisprudence, if the transparency condition is not satisfied, the measure will be deemed to confer an advantage and amount to an aid. Moving now to the WTO context, it is interesting to speculate whether the lack of transparency in the price-discovery mechanisms would defeat the no-benefit presumption and lead to consider the measure a subsidy.

The fourth condition, and in particular the reference/incentive to public procurement procedures, has been discussed extensively, and is arguably the most significant area of overlap between EU and WTO law in this respect.

In principle, what the Appellate Body could do in this respect is to be clear and ensure that the design and execution of the procedure should be such as to achieve its result of cost-efficiency and low distortions.

There are two types of issues here.

The first order of difficulties concerns the possibility that 'price-discovery mechanisms' achieve the desired results. A tender may lead to very different results depending on its design and, most crucially, does not necessarily lead to the provision of a service at the least possible cost.⁷⁴ One does not need to think at possible collusive behavior to reach this conclusion.⁷⁵

The second type of challenges focuses on the various issues that need to be conceptually and practically clarified to ensure that the act of selection of the provider does not confer a benefit – which is the concern of subsidy control.

What does 'lowest cost' mean for the Appellate Body? Does it refer to the 'lowest price' which in the EU is deemed to 'obviously satisfy the fourth *Altmark* condition'? Or does it rather refer to 'most economically advantageous tender' where also non-economic (say social or environmental) criteria may be considered? This distinction was very sensitive in the EU and caused much debate during the genesis of the European Commission Communication (European Commission (2012a)).⁷⁶ The issue, however, is that, strictly speaking, only a criterion that purely and exclusively refers to the lowest cost at which the market can offer the good or the service can ensure, in a subsidy context, a no-benefit and no-subsidy determination.⁷⁷

In other words, while public procurement may come to the aid of subsidy control, their focus is slightly different. The former's goal is efficiency, in the sense of public-expenditure reduction. The latter's objective is the exclusion of competitive advantages. In other words, in the context of the benefit analysis, the use of price-discovery mechanisms is of help only if it produces an outcome that is, at least, as efficient as that of normal market transactions.

That is why there is a fallacy in saying that the 'mere compensation' of costs does not give any benefit. This is far too indeterminate. The key economic issues— underlined in the analysis of 'necessity' above – are left unresolved. Sykes and Neven (2013) rightly note that these procedures, *if properly designed*, may *reduce* the rents of the bidders. But, when a subsidy determination is at issue, what matter is that the rents are not simply 'reduced' but rather that they are equal to those that the market would consider justified.

Consequently, the Appellate Body was right when it started its analysis by underlining the importance of market definition. This finding holds true even when public authorities resort to price-discovery mechanisms to source their needs. One thing is to define the market, quite another to recognize that a procedure may ensure that the price paid is the best (ie corresponds to the benchmark) in that market. Market definition and benchmarking are different and complementary steps. One cannot replace the other.

⁷⁴ See, eg, Kemplerer (2002).

⁷⁵ See also Gerardin (2012) and Santamato and Pesaresi (2004).

⁷⁶ See Righini (2012). Article 67 of the Communication laconically reads: 'As to the award criteria, the 'lowest price' obviously satisfies the fourth *Altmark* criterion. Also the 'most economically advantageous tender' is deemed sufficient, Provided that the award criteria, including environmental or social ones, are closely related to the subject-matter of the service provided and allow for the most economically advantageous offer to match the value of the market.'

⁷⁷ See Cosbey and Rubini (2013) at pp. 9-10.

It is worth repeating this important point. It is market definition that defines the universe, the ‘search box’ where to find the benchmark. It is only within the four corners of this universe that price-discovery mechanisms can be used to ‘create a competition in the market’ and benefit from the results of this contest. If properly designed, these procedures can genuinely lead to a situation where ‘the price paid by the government is the lowest possible price offered by a willing supply contractor’.

If one really wanted to remove any room for an economic advantage, the call specifications should be formulated without referring to the source of or process to generate energy, or indeed any other public policy objective, and just, plainly refer to what a private operator would search in the market, in our case: energy or electricity.

We go back to square one, and to the Appellate Body’s original sin of having defined the market too much narrowly.

There is, however, some hope. In the *Canada – Renewable Energy/FIT* case, the first innovation (the definition of the relevant market) is conducive to the second one (the benchmarking). The essence of the problem is that, in applying its new approach, the Appellate Body’s definition of the market was too narrow and the ensuing benchmarking too vague, and potentially broad. The best service to clarification-and-narrowing of its law that the Appellate Body could now do is *to take the inherent link between the definition of the market and benchmarking seriously*.⁷⁸ As noted by several commentators to the case, the best service to WTO subsidy control, and the green energy revolution, Members could do is to seriously start talking about law reform.

9. Conclusions

The *Canada – Renewable Energy/FIT* decision left us with bad law. This is not good news for governments and business alike. This piece kicked off from the premise that it will be difficult to have any momentous *revirement*, especially in the current regulatory framework which does not provide for any express justification for good subsidies. After outlining the risks that a normalization and expansion of this ruling may pose, we have responded to the call for clarification-and-narrowing of the law of this case and speculated on how this could be done. The EU *Altmark* decision of the European Court of Justice, which was certainly in the mind of the EU litigators and whose ethos the Appellate Body embraced by referring to the use of ‘price-discovery mechanisms’, has inspired our speculation about the future of benchmarking. Our exercise has, however, exposed many challenges and difficulties, many of them already occurred in EU law. The amount of helpful clarification the WTO judicature could offer is limited, and would probably be restricted to taking the link between market definition and benchmarking seriously. This unsatisfactory situation leads us to suggest, once again, that the only solution to the current ‘turquoise mess’ is law reform.⁷⁹

⁷⁸ ‘The definition of the relevant market is central to, and a prerequisite for, a benefit analysis under Article 1.1(b) of the SCM Agreement’ (Appellate Body Report, para. 5.169).

⁷⁹ See Rubini (2015). A nice side-effect of reforming subsidy rules and making them more responsive to policies supporting green energy is that it would arguably contribute to make the ‘*Canada - Renewable Energy* carve-out’ unnecessary and its precedential value redundant.

References

- Bigdeli, S. (2014) 'Clash of Rationalities: Revisiting The Trade and Environment Debate in Light of WTO Disputes over Green Industrial Policy', *Trade, Law and Development*, 177-209
- Biondi, A. and L. Rubini (2005), '*Aims, Effects and Justifications: EC State Aid Law and its Impact on National Social Policies*', in Dougan & Spaventa (eds) *Social Welfare and EU Law* (Hart Publishing) 79-103
- Breckenridge, A. (2013a), *FIT for purpose? A Review of the economics of a WTO Panel ruling on Feed-in tariffs and local content requirements*, Client Briefing, Frontier Economics, March 2013.
- Breckenridge, A. (2013b), *A Matter of Definition – Commentary of Aspects of the Appellate Body's Ruling on the Canada – Renewable Energy Case in the WTO*, Client Briefing, Frontier Economics, October 2013
- Casier, L. and T. Moerenhout, *WTO Members, Not the Appellate Body, Need to Clarify Boundaries in Renewable Energy Support*, *IISD Commentary*, July 2013
- Charnovitz, S. and C. Fischer (2014), 'Canada – Certain Measures Affecting the Renewable Energy Generation Sector / Canada – Measures relating to the Feed-In Tariff Program', RSCAS 2014/109 Robert Schuman Centre for Advanced Studies Global Governance Programme, Working Paper
- Cosbey, A. and P.C. Mavroidis, 'A Turquoise Mess: Green subsidies, Blue Industrial Policy and Renewable Energy: The Case for Redrafting the Subsidies Agreement of the WTO', *Journal of International Economic law*, pp.11-47
- Cosbey, A. and L. Rubini (2013), *Does it FIT? An assessment of the effectiveness of renewable energy measures and of the implications of the Canada – Renewable Energy/FIT disputes*, E-15 Issue Paper, Autumn 2013
- European Commission (2014a), Communication from the Commission — Guidelines on State aid for environmental protection and energy 2014-2020, OJ C 200, 28.6.2014, pp. 1–55
- European Commission (2014b) European Commission Memo, Energy and Environmental State Aid Guidelines – Frequently asked questions, Brussels, 9 April 2014
- European Commission (2012a), Communication from the Commission on the application of the European Union State aid rules to compensation granted for the provision of services of general economic interest, OJ 2012 C 8/4
- European Commission (2012b), Commission Decision of 20 December on the application of Article 106(2) of the Treaty on the Functioning of the European Union to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest OJ 2012 L 7/13
- European Commission (2012c), Communication from the Commission, European Union framework for State aid in the form of public service compensation (2011). OJ 2012 C 8/15
- European Commission (2012d), Commission Regulation on the application of Articles 107 and 108 of the Treaty on the Functioning of the European Union to de minimis aid granted to undertakings providing services of general economic interest, OJ L 114, 26.4.2012, pp. 8–13
- European Commission (2005a), Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest (notified under document number C(2005) 2673) OJ L 312, 29.11.2005, p. 67–73
- European Commission (2005b), Community framework for State aid in the form of public service compensation OJ C 297, 29.11.2005, p. 4–7

- European Commission (2005c), Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings (Codified version) (Text with EEA relevance) **OJ L 318**, 17.11.2006, p. 17–25
- European Commission (1997), EU Commission Notice on the definition of the relevant market for the purposes of Community competition law, **OJ C 372**, 9.12.1997, pp. 5-13
- Hestermeyer, H. and L. Nielsen (2014), ‘The Legality of Local Content Measures under WTO Law’, *Journal of World Trade*, pp. 553-591
- Kemplerer, P. (2002), ‘What Really Matters in Auction design’, *Journal of Economic perspectives*, 2002, 169-189
- Kent, A. and V. Jha (2014), ‘Keeping Up with the Changing Climate: The WTO’s Evolutive Approach in Response to the Trade and Climate Conundrum’, *Journal of World Trade of Investment and Trade*, pp. 245-271
- Krueger, T. (2013), ‘Shaping the WTO’s institutional evolution: the EU as a strategic litigant in the WTO’, in D. Kochenov and F. Antembrink (eds), *The European Union's Shaping of the International Legal Order* (Cambridge: Cambridge University Press, at pp. 169-190
- Gerardin, D. (2012), ‘Public Compensation for Services of General Economic Interest: An Analysis of the 2011 European Commission Framework’, *European State Aid Law Quarterly*, Supplement 2012/2, pp. 51-62
- Lang, A. (2014), *Governing ‘As If’: Global Subsidies Regulation and the Benchmark Problem*, LSE, Law, Society and Economy Working Papers 12/2014, August 2014
- Neven, D. and A. Sykes (2014), ‘United States – Measures Affecting Trade in Large Civil Aircraft (Second Complaint): Some Comments’, *World Trade Review*, 281-298
- Nitsche, R. and P. Heidhues (2006), Study on methods to analyse the impact of State aid on competition, European Commission Economic Paper, Number 244, February 2006.
- Pal, R. (2014), ‘Has the Appellate Body’s Decision in Canada – Renewable Energy / Canada – Feed-in Tariff Program Opened the Door for Production Subsidies’, *Journal of International Economic Law*, pp. 125-137
- Righini, E. (2012), ‘The Reform of the State Aid Rules on Financing of Public Services Paving the Way towards a Clearer, Simpler and more diversified Framework’, *European State Aid Law Quarterly*, Supplement 2012/2, pp. 3-16
- Rubini, L. (2015), *ASCM disciplines and recent WTO case law developments: what space for ‘green’ subsidies?*, RSCAS 2015/03 Robert Schuman Centre for Advanced Studies Global Governance Programme, Working Paper.
- Rubini, L. (2014a), *What does the recent WTO litigation on renewable energy subsidies tell us about methodology in legal analysis? The Good, the Bad, and the Ugly*, RSCAS 2014/05 Robert Schuman Center for Advanced Studies, Working Paper.
- Rubini, L. (2014b), ‘The good, the bad, and the ugly. Lessons on methodology in legal analysis from the recent WTO litigation on renewable energy subsidies’, *Journal of World Trade*, pp. 895-938
- Rubini, L. (2009), *The Definition of Subsidy and State Aid: WTO and EC Law in Comparative Perspective* (Oxford: Oxford University Press)
- Santamato, S. and N. Pesaresi (2004). ‘Compensation for services of general economic interest: some thoughts on the Altmark ruling’, *Competition policy Newsletter*, Number 1, Spring 2004, pp. 17-21.

Santos, A. (2013), 'Carving Out Policy Autonomy for Developing Countries in the World Trade Organization – The Experience of Brazil and Mexico', in D.M. Trubek, H.A. Garcia, D.R. Coutinho, A. Santos, *Law and the New Developmental State* (Cambridge: Cambridge University Press, 2013), at pp. 167-245

Sykes, A.O. (2010), 'The Questionable Case for Subsidies Regulation: A Comparative Perspective', *Journal of Legal Analysis*, pp. 473-523

Author contacts:

Luca Rubini

Global Governance Programme
Robert Schuman Centre for Advanced Studies
European University Institute
Villa La Fonte
Via delle Fontanelle 10
50014 San Domenico di
Fiesole, Italy
Email: luca.rubini@eui.eu

and

Birmingham Law School
University of Birmingham
Edgbaston
B15 2TT Birmingham, UK
Email: l.rubini@bham.ac.uk