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# CANADA – MEASURES AFFECTING THE IMPORTATION OF MILK AND THE EXPORTATION OF DAIRY PRODUCTS

Recourse to Article 21.5 of the DSU by
New Zealand and the United States

***Report of the Panel***

The report of the Panel on Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products, Recourse to Article 21.5 of the DSU by New Zealand and the United States is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 11 July 2001 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1).

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## I. INTRODUCTION

1.1 On 23 December 1999, pursuant to Article 21.3(b) of the DSU, Canada, New Zealand and the United States agreed (WT/DS103/10; WT/DS113/10) on the reasonable period of time for implementation of the recommendations and rulings of the Dispute Settlement Body (the DSB) in the matter of "Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products". According to the terms of the 23 December 1999 agreement, as amended on 11 December 2000 (WT/DS103/13; WT/DS113/13), the staged implementation process, "including any new measures for the export of " dairy products, was to be completed by 31 January 2001.

1.2 On 19 January 2001, Canada circulated to all Members of the DSB (WT/DS103/12/Add.6, WT/DS/113/12/Add.6) its "final status report", pursuant to Article 21.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the DSU). In that report Canada affirmed "that it will be in full compliance with the rulings and recommendations of the DSB by the conclusion of the implementation period" on 31 January 2001.

1.3 New Zealand and the United States consider that Canada has failed to comply with the above mentioned recommendations and rulings of the DSB by 31 January 2001.

1.4 Without prejudice to their rights under the WTO, and in accordance with paragraph 1 of the 21 December 2000 "Agreed Procedures between Canada, New Zealand and the United States under Articles 21 and 22 of the Dispute Settlement Understanding in the follow-up to the dispute in "Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products" (WT/DS113/14 and 103/14, respectively) (Agreed Procedures), New Zealand and the United States requested consultations with Canada on 2 February 2001. Consultations were held on 9 February 2001, but failed to resolve the dispute.

1.5 Pursuant to Article 21.5, and as envisaged in the Agreed Procedures, New Zealand and the United States on 16 February 2001 accordingly requested the establishment of a panel in this matter and requested that the DSB refer the matter to the original panel, if possible (WT/DS113/16 and 103/16, respectively.)

1.6 On 16 February 2001, New Zealand and the United States also requested authorization from the DSB, pursuant to Article 22.2 of the DSU, to suspend the application to Canada of tariff concessions and other obligations under the General Agreement on Tariffs and Trade 1994 (GATT 1994) covering trade in the amount of US$35 million for each complainant. Pursuant to Article 22.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Canada objected on 28 February 2001 to the level of suspension of tariff concessions and other obligations under the GATT 1994 proposed by New Zealand and the United (document WT/DS113/17 and 103/17, respectively). In accordance with the provisions of Article 22.6 of the DSU and as envisaged in the "Agreed Procedures, Canada therefore requested that this matter be referred to arbitration.

1.7 In accordance with the Agreed Procedures, the complainants did not object to the referral of the level of suspension of concessions or other obligations to arbitration pursuant to Article 22.6 of the DSU. In this case, New Zealand and the United States agreed to request the arbitrator to suspend its work until either (a) the adoption of the Article 21.5 compliance panel report; or (b) if there were an appeal, the adoption of the Appellate Body report.

1.8 At its meeting on 1 March 2001, the Dispute Settlement Body (DSB) decided, in accordance with Article 21.5 of the DSU, to refer to the original Panel, if possible, the matter raised by New Zealand and the United States in documents WT/DS113/16 and WT/DS103/16, respectively.

*(i) Terms of reference*

1.9 At that DSB meeting, it was also agreed that the Panel should have standard terms of reference as follows:

> "To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS103/16 and by New Zealand in document WT/DS113/16, the matter referred to the DSB by the United States and New Zealand in those documents and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

*(ii) Composition of Panel*

1.10 The Panel was composed on 12 April 2001 as follows:[1]

| | |
|---|---|
| Chairperson: | Mr. Ernst-Ulrich Petersmann |
| Members: | Mr. Guillermo Aguilar Alvarez |
| | Mr. Peter Palecka |

1.11 Australia, the European Communities and Mexico reserved their third party rights.

1.12 The Panel held a meeting with the parties on 29-30 May 2001 and with the third parties on 30 May 2001. The report of the Panel was submitted to the parties on 5 July 2001.

[1] The Chairperson of the original Panel, Mr. Tommy Koh, was not available for these proceedings. The parties agreed to his replacement by Mr. Peter Palecka as a member of the Panel.

## II. PRELIMINARY RULINGS

### 1. Canada's request concerning business confidential information

2.1 On 15 May 2001, **Canada,** pursuant to paragraph 12 of the Panel's working procedures, requested a preliminary ruling from the Panel regarding the adoption of procedures governing business confidential information (BCI) that may be submitted to Canada in the course of these proceedings. Canada proposed that such procedures form part of the Panel's working procedures pursuant to paragraph 14 thereof and Article 12.1 of the DSU.

2.2 Canada indicated that Canadian producers and processors proposing to submit BCI to the Canadian litigation group in the context of these proceedings need BCI procedures to be in place before disclosure is made.[2] Currently, Canada did not have access to certain BCI and would not be in a position to obtain, assess and provide such BCI to the Panel or to the other Parties unless adequate procedures are in place to govern its handling and the access thereto in the course of these proceedings. That is why Canada requested BCI procedures and proposed procedures that are built upon those adopted in the *Brazil and Canada Aircraft* cases, the *Australia - Automotive Leather* case and the *United States - Wheat Gluten* case.[3] The objective is to provide the Panel and all parties involved in the dispute, including third parties, with all relevant factual information necessary to arrive at correct factual and legal conclusions. Canada contended that it would not be able to do so without these procedures in place.

2.3 Canada submitted that the confidentiality provisions already applicable to this dispute are paragraph 3 of the model working procedures set out in Annex 3 of the DSU[4] and Article 18.2 of the DSU. In many cases these provisions may provide sufficient protection for information which a Member may want to form part of the factual record of the proceedings. In some cases, these provisions may suffice even to protect BCI from being disclosed beyond the parties to a dispute.

2.4 Article 12.1 of the DSU, Canada submitted, explicitly allows the Panel to adapt its working procedures to the circumstances of the case before it. Under the procedures proposed in Appendix I, a Member party to this dispute would not be denied access to BCI. While specific persons within the Member's delegation or larger consultative group would be excluded from access to specific numerical and other BCI, they would be provided with a summary form of the information which would enable them to draw the appropriate analytical conclusions. In light of the considerations set out above, Canada respectfully requested that the Panel adopt the BCI procedure, as proposed by Canada, as part of its working procedures.

2.5 **New Zealand** did not see a need for additional working procedures for BCI in relation to the current proceedings. Article 18 and Appendix 3 of the DSU already provide sufficient coverage for the concerns that Canada has expressed and, in any event, New Zealand did not believe that Canada has adequately demonstrated the need for stepping beyond the parameters of these provisions.

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[2] Canada indicated that within the Canadian delegation and wider consultative group itself, procedures similar to those requested here would govern the handling of BCI.

[3] *Brazil – Aircraft*, panel report; *Canada – Aircraft*, panel report; *Australia – Automotive Leather* panel report; *United States – Wheat Gluten*, panel report.
**Please note that the full title of all cases referred to here and in the rest of the report can be found in the Annex on page 68.**

[4] By virtue of Article 12.1 of the DSU and paragraph 1 of Annex 3 of the DSU, paragraph 3 of Annex 3 of the DSU is also paragraph 3 of the Working Procedures of this Panel.

2.6 As Canada recognised, the DSU already contains provisions which deal with the issue of ensuring confidentiality in dispute settlement proceedings. In New Zealand's view, Article 18 and Appendix 3 of the DSU adequately ensure that, when a party to a dispute submits information which it designates as "confidential", all other parties to the dispute are under an obligation to treat such information as confidential. This is confirmed *inter alia* by the Appellate Body in *Canada - Aircraft* where the Appellate Body noted, *inter alia*, that Article 18.2 obliges Members to "maintain the confidentiality of any submissions or information submitted, or received" in a dispute settlement proceeding.[5] The Appellate Body went on to observe that such a provision also "oblige[s] Members to ensure that such confidentiality is fully respected by any person that a Member selects to act as its representative, counsel or consultant."[6]

2.7 New Zealand also observed that there is no precedent for BCI procedures being imposed on a party to a dispute under the DSU. Additionally, and most importantly, there is no precedent for the working procedures of a panel being substantively modified over the objections of one of the principal parties to a dispute.

2.8 New Zealand noted that on the only occasion when the Appellate Body has been asked to consider the issue of BCI procedures (in Canada-Aircraft), it declined the request of the parties, who had agreed such procedures at the panel stage, to apply those procedures *mutatis mutandis* to proceedings before the Appellate Body. Moreover, it refused to agree to impose those procedures on third participants in the appeal.[7] New Zealand also submitted that in the circumstance where there is no precedent for BCI procedures to be imposed on a party to a dispute, the burden on Canada to justify its proposal is a heavy one which Canada has by no means met.

2.9 New Zealand considered that if Canada's concerns are being driven by domestic considerations whereby some parts of its industry want to protect information from other parts of the Canadian industry, then this is an internal matter for Canada and is of no concern to New Zealand or the Panel. In New Zealand's view, pertinent information in relation to the so-called "commercial export milk" is already before the Panel. As a result, New Zealand was unclear as to what additional information Canada believes is "necessary" for the Panel to resolve this dispute.

2.10 In light of the above, New Zealand requested that the Panel decline Canada's request for additional working procedures in relation to BCI. Such additional procedures would be unnecessary and would serve no useful purpose in the upcoming hearing.

2.11 The **United States** shared some of New Zealand's concerns and was not advocating the adoption of such procedures. At the same time, the United States would not object to the inclusion of BCI procedures in this case as long as they adequately address the concerns raised by the United States. The United States opposed the adoption of Canada's proposal without modifications based on its objection to the following provisions: 1) the definition of "business confidential information", 2) the inclusion of outside legal counsel or other advisor or consultant to a party in the definition of "representative", 3) the exclusion of government employees involved in the dairy field from the definition of "representative", and 4) the inclusion of provisions for the submission of BCI to third parties. The United States was concerned that if the Panel were to adopt the procedures proposed by Canada without modification, the systemic ramifications could be severe. For example, other panels could use the procedures as a model in other disputes. These procedures have a number of flaws and may be particularly inappropriate, or even inconsistent with WTO obligations, if used in another

[5] *Canada - Aircraft*, Appellate Body report, paragraph 145.
[6] *Id.*
[7] *Id.*, paragraph 147.

context such as a dispute brought under the Agreement on Safeguards or the Anti-dumping Agreement.

2.12 With regard to outside legal counsel, although the United States understood that a party may include outside legal counsel in its delegation, the United States did not believe that the sanctions in place under the DSU and WTO rules are sufficient to ensure that BCI is adequately protected if access is permitted for outside legal counsel. Moreover, there is too great a potential for a conflict of interest. The situation in *Thailand - Steel* demonstrates the danger of submitting BCI to outside legal counsel who may also represent a domestic stakeholder. In that case, different representatives of the same law firm represented the government and the private sector association. Despite the fact that the law firm, as a representative or counsel to the government, was bound by the same confidentiality obligations under the DSU as Poland, the private sector association somehow came into possession of Thailand's brief. For *inter alia* these reasons, the United States proposed striking "legal counsel or other advisor or consultant of a party" from the definition of "representative " and striking entirely the provision for submission of BCI to third parties.

2.13 Furthermore, the United States considered that information other than business proprietary information does not need protection as business confidential information. Such a broad definition imposes an even greater burden on the Panel and parties and is not consistent with the restrained use of the BCI designation. Also, this definition is not consistent with the rationale provided by Canada in support of its need for BCI procedures.

2.14 As concerns the definition of "representatives", the United States considered that the proposal for exclusion of government employees involved in the dairy field is overly broad. The United States would propose striking "government" from the exclusion in the definition of "representative", or at least making it clear that the exclusion only applies to government entities that are actual market participants. The United States accordingly requested that if the Panel decides that the adoption of BCI procedures is warranted in this case, that it adopt the Canadian procedures as BCI procedures with the modifications proposed by the United States. And in any event the procedures should specify that they are applicable only to BCI submitted by Canada.

*(i) The Panel's decision*

2.15 After having reviewed Canada's request and the comments by New Zealand and the United States, the **Panel** decided to decline, at the time of its preliminary ruling[8], Canada's request to adopt the procedures governing BCI proposed by Canada. The Panel reached this conclusion on the basis of the following considerations.

2.16 The Panel considers that Article 18.2 of the DSU[9] and paragraph 3 of the Panel's Working Procedures[10] already provide substantial protection to parties regarding treatment of BCI.[11]

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[8] 23 May 2001.

[9] Written submissions to the panel of the Appellate Body shall be treated as confidential, but shall be available to the parties to the dispute. Nothing in this Understanding shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the panel or the Appellate Body which that Member has designated as confidential. […]

[10] The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential. […]

2.17 The Panel notes that New Zealand does not see the need for BCI procedures[12], and that the United States does not intend to submit BCI.[13] The Panel considers that it has the authority to amend the Working Procedures, after consulting the parties, including the possibility to adopt procedures governing BCI, pursuant to Article 12.1 of the DSU and paragraph 14 of the Working Procedures. It also considers that it would not be prevented from doing so because the parties to the dispute are in disagreement regarding such a proposed amendment, provided that requirements of due process are respected. Article 12.1 of the DSU only provides that the Panel should consult with the parties.

2.18 The Panel considers that it needs to examine Canada's request in the light of a panel's obligation under Article 11 of the DSU to make an objective assessment of the facts of the case. If certain information is required to allow the Panel to make an objective assessment of the facts and such information cannot reasonably be expected to be disclosed to the Panel and the parties in the absence of additional procedures governing BCI, the Panel would need to accommodate a party's concerns regarding treatment of BCI. A panel's decision not to do so in such circumstances might very well affect that party's due process rights, as that party might find itself unable to disclose information necessary to its defence, and hence, make it impossible for the Panel to make an objective assessment of the facts.

2.19 At the same time, the Panel considers that a party requesting the adoption of BCI procedures should clearly explain to the Panel what kind of information it may be unable to obtain and disclose but for the adoption of BCI procedures, in order to enable the Panel to assess the need for such BCI procedures. In this respect, the Panel notes that Canada does not provide any indication as regards the nature of the information which it may consider necessary or desirable to disclose during the proceedings, and which it considers it could not disclose in the absence of BCI procedures. Rather, Canada limits itself to stating that:

> "One of the provisions that may form part of a commercial transaction involving milk for use in products destined for export […], is the confidentiality of terms of the contract, or indeed, of the entire contract itself. Confidentiality covenants along these lines are commonplace in commercial transactions. […][14]
>
> […] Canadian producers and processors proposing to submit BCI to the Canadian litigation group in the context of these proceedings need BCI procedures to be in place before disclosure is made.[15] Currently, Canada does not have access to certain BCI and will not be in a position to obtain, assess and provide such BCI to the Panel or to the other Parties unless

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[11] See the Appellate Body report on *Canada –Aircraft*, paragraph 145, where the Appellate Body notes, with approval, the following statement made by the Panel in *Indonesia –Automobiles*, paragraph 14.1.:
"We would like to emphasize that *all members of parties' delegations - whether or not they are government employees -- are present as representatives of their governments, and as such are subject to the provisions of the DSU and of the standard working procedures, including Articles 18.1 and 18.2 of the DSU and paragraphs 2 and 3 of those procedures*. In particular, parties are required to treat as confidential all submissions to the Panel and all information so designated by other Members; and, in addition, the Panel meets in closed session. *Accordingly, we expect that all delegations will fully respect those obligations and will treat these proceedings with the utmost circumspection and discretion*. […]." (emphasis added by the Appellate Body).

[12] Paragraph 2 of the response by New Zealand, 21 May 2001.

[13] Paragraph 2 of the response by the United States, 21 May 2001.

[14] Paragraph 3 of Canada's request for a preliminary ruling, 15 May 2001.

[15] [Footnote omitted]

adequate procedures are in place to govern its handling and the access thereto in the course of these proceedings."[16]

2.20 While the Panel understands that confidentiality clauses may prevent private entities from disclosing certain or all information contained in a contract[17], it notes that certain data in connection with such contracts, albeit not on an individual basis, has already been made available by the parties to the dispute, including Canada.[18] The Panel does not, and, of course, cannot, exclude that there may be other factual information which Canada may wish to provide and which would assist the Panel in making an objective assessment of the facts. The Panel considers, however, that for BCI procedures to be put in place, with the associated burden imposed on the Panel and the parties, Canada would, at least, need to describe to the Panel the nature of that information, and why the existing confidentiality requirements are insufficient. Only then would the Panel be able to assess the need to adopt BCI procedures.

2.21 In conclusion, Canada's request has not enabled the Panel to assess the need for the proposed procedures governing BCI. The Panel is therefore not persuaded at this time that it should adopt BCI procedures, as proposed by Canada. The Panel, however, does not exclude that it may need to revisit the issue at a later time, if and when Canada provides additional justification and clearly establishes the need for additional arrangements regarding BCI.[19] The Panel is committed to protecting the due process rights of all parties to the dispute and will take any appropriate action for that purpose in the course of the proceedings, after consulting the parties.

## 2. The European Communities request concerning access to the rebuttals for third parties

2.22 On 18 May 2001 the **European Communities** (EC) made the following request concerning third party access to the rebuttals. The EC noted that paragraph 8 of the Working Procedures of the Panel provides in relevant part that "Third parties shall receive copies of the parties' first written submissions". In the view of the EC, this regulation conflicts with Article 10. 3 of the DSU which states that "Third parties shall receive the submissions of the parties to the dispute to the *first meeting* of the Panel". (emphasis added)

2.23 The EC argued that it had continuously objected to similar Working Schedules of previous compliance panels. The DSU Article 21.5 panel in *Australia - Automotive Leather* justified its approach solely with the following argument: "If it had decided to hold two meetings, with the parties, as in the normal situation envisioned in Appendix 3 of the DSU, third parties would have received only the written submissions made prior to the first meeting, but not the rebuttals or other submissions made subsequently."[20] The EC considered that this reasoning is not tenable. The argument is based on the assumption that two substantive meetings are the "normal situation" in DSU Article 21.5 proceedings. The EC recalled that, due to the expedited nature of compliance panels, *all*

[16] Paragraph 4 of Canada's request for a preliminary ruling, 15 May 2001.

[17] The Panel notes that none of the "Examples of Commercial Export Milk Contracts" provided by Canada in Exhibit 15 to its First Submission contain any obligations as regards confidentiality of their terms and conditions.(Exhibit 15 erroneously referred to as Exhibit 14 in the original ruling) The Panel is aware, however, that those examples may not necessarily constitute a representative sample in this respect.

[18] Including average prices, traded volumes and supply terms. See paragraphs 42 and 51 of Canada's first submission, 15 May 2001.

[19] The Panel is fully aware that Canada's request for adoption of BCI procedures needs to be assessed in the light of Article 10.3 of the *Agreement on Agriculture*.

[20] *Australia – Automotive Leather*, recourse to Article 21.5, panel report, paragraph 3.9.

DSU Article 21.5 panels so far have only held *one* substantive meeting.[21] This is, thus, the normal situation.

2.24 The practice of giving third parties only the first submissions, the EC continued, deprives them of their participatory rights under the DSU. Article 10.1 of the DSU emphasises that the "interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process". The EC believed that its systemic interest in the correct interpretation of the *Agreement on Agriculture* can only be protected if it can contribute meaningfully to the Panel proceedings by giving its views on all arguments exchanged by the parties before the first and only substantive meeting of the Panel, as foreseen by Article 10.3 of the DSU.

2.25 The EC submitted that Article 12.1 of the DSU grants each panel the authority to adapt the Working Procedures "after consulting the parties to the dispute". However, Article 12.1 of the DSU does not grant any panel the authority to *"limit* the right of third parties under Article 10.3 to receive the submissions of the parties to the dispute to the first meeting to copies of the first submissions of the parties".[22] The Appellate Body, in *United States - 1916 Act* has only acknowledged the discretionary authority of panels to grant *extended* third party rights.[23]

2.26 The EC noted that even if previous DSU Article 21.5 panels have similarly excluded the third parties from the second set of submissions, such a practice, which is, in the opinion of the EC, in conflict with the express provisions and the objectives of the DSU, cannot be considered as being justified because it has also been followed in some other procedures. On the basis of the foregoing considerations, the EC was of the view that this Panel should ensure that the third parties receive the second set of submissions to be exchanged before its substantive meeting.

2.27 **Canada** noted that its general policy is to make available, upon request, a public version of the submissions it has filed. Accordingly, the EC can receive Canada's rebuttal submission, as can the other third parties, as of 25 May 2001, if they so request. Canada's response in this case is without prejudice to Canada's position on the broader question of whether third parties have a right under the DSU to receive the rebuttal submissions of disputing parties before the hearing, in the context of dispute settlement proceedings under Article 21.5 of the DSU.

2.28 **New Zealand** did not oppose the EC request but noted that any decision by the Panel to accede to the EC request should be seen as being confined to this dispute and without prejudice to the rights and obligations contained under the DSU.

2.29 The **United States** noted that the EC has made similar arguments in other Article 21.5 proceedings in which a panel has held only a single meeting with the parties and third parties, and in each such proceeding, the panel has rejected the EC argument. The first in this line of cases is *Australia - Automotive Leather*, in which the panel rejected the EC request.[24] The panel in *Australia-Salmon - f*aced a similar argument by the EC and also found that third parties are not entitled to rebuttal submissions in Article 21.5 panel proceedings where there is only one substantive meeting of

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[21] *Australia – Automotive Leather*; *Australia – Salmon*; *United States – DRAMS*; *Canada – Aircraft*; *Brazil – Aircraft*; *EC – Bananas (Ecuador)*; *United States – FSC*; *United States – Shrimps*; *Mexico – High Fructose Corn Syrup*; *Brazil – Aircraft – Second Recourse to Article 21.5 of the DSU.*

[22] This was expressly done in the Article 21.5 panel report, *Australia – Salmon"*, paragraph 7.5.

[23] *United States – 1916 Act*, Appellate Body report, paragraphs 139-150.

[24] *Australia - Automotive Leather*, Recourse to Article 21.5, panel report, paragraph 3.9. This decision was followed in *Australia - Salmon*, Recourse to Article 21.5, panel report, paragraphs 7.5-7.6.

the panel.[25] More recently, the panel in *United States - DRAMS* also rejected the EC's position.[26] In the view of the United States, the reasoning of these prior panels is sound, and should be followed by this Panel.

2.30 The United States also urged the Panel to reject the EC's assertion that Article 12.1 of the DSU requires that the EC be consulted regarding the provisions of the Working Procedures in this case involving third party rights. Article 12.1 states clearly that panels are to consult the parties to the dispute, not the third parties. The United States noted that, with the exception of business confidential information, it routinely makes its submissions to WTO panels available to the public by placing its submissions on the Internet Web page of the Office of the US Trade Representative. Thus, as a practical matter, third parties (along with the rest of the world) have access to the US rebuttal submission. The United States understood that both Canada and New Zealand may also make their rebuttal submissions public. In any event, the working procedures make it clear that the other parties to the dispute have the option to provide copies of their rebuttal submissions to the EC. In conclusion, the United States asked that the Panel follow the consistent positions of past panels on this issue and reject the EC's request.

2.31 **Mexico** submitted that although it recognized the right of panels to deviate from the working procedures set forth in Appendix 3 to the DSU, a panel may not act in a manner contrary to the actual provisions of the DSU, in particular when this affects the rights of third parties. According to Mexico, Article 10.3 of the DSU clearly stipulates that third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel. Thus, if in the case of an accelerated procedure the panel decides to conduct its first meeting after receiving the rebuttal submissions, this must not affect the rights of third parties to have their interests fully taken into account, including the right to receive all of the submissions of the parties to the first meeting of the panel. Pragmatic arguments such as the fact that the parties to the dispute have a policy of making their rebuttals public are, in Mexico's view, not acceptable. Mexico put forward three general observations in this respect: (i) the right of third parties includes the right to receive submissions from the parties without having to seek them; (ii) certain Members only publish the actual texts of their submissions, and not the annexes; (iii) the third parties are not necessarily always English speaking. In view of the above, Mexico supported and associated itself with the EC's request that the rebuttal submissions of the parties be provided.

*(i) The Panel's decision*

2.32 After having reviewed the EC's request and the comments by the parties, the **Panel** decided[27] to accept the EC's request, and accordingly amend its Working Procedures. The Panel reached this conclusion on the basis of the considerations presented hereafter. Appendix 3 to the DSU requires this Panel to "follow the relevant provisions of this Understanding" (paragraph 1) subject to the power of the Panel to adopt "any additional procedures specific to the panel" (paragraph 11). In this case, all parties and third parties agree that Article 10.3 of the DSU remains applicable and requires that "(t)hird parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel". The disagreement relates as to whether the third party rights under Article 10.3 of the DSU have been inappropriately limited by the Panel when it adopted, in accordance with the practice of previous Article 21.5 panels and in agreement with the parties to this dispute, the following rule in

[25] *Australia- Salmon,* Recourse to Article 21.5, panel report, paragraphs. 7.5 and 7.6.

[26] *United States - DRAMS* - Recourse to Article 21.5, Decision of the panel concerning the EC request for access to the parties' rebuttal submissions, 27 June 2000 (footnotes omitted).

[27] Decision dated 25 May 2001.

paragraph 8 of this Panel's Working Procedures: "Third parties shall receive copies of the parties' *first* written submissions".[28] (emphasis added)

2.33 Referring to the EC's claims in paragraphs 2.22 - 2.26 above, as supported by Mexico in paragraph 2.31, the Panel noted that the text of Article 10.3 is clear and requires this Panel to make available to third parties "*the* submissions of the parties to the dispute to the first meeting of the panel" (emphasis added). In the particular context of Article 21.5, panels which, as in this case, request both parties to submit also their rebuttal submissions prior to the first meeting with the parties, the literal reading of Article 10.3 clearly requires to make available to third parties also these rebuttal submissions. Even in the different context of normal Article 12 panel proceedings with two meetings with the parties, nothing in the text of Article 10.3 and in the different context of normal Article 12 panel proceedings justifies ignoring the clear textual requirement of Article 10.3 to enable third parties to participate in the first panel meeting with access to *all* "the submissions" of the parties made up to this point of the panel process. In the particular context of this Article 21.5 Panel proceeding, the term "submissions" in Article 10.3 of the DSU must therefore include the parties' rebuttal submissions.

2.34 In the view of the Panel, only this strict compliance with the unequivocal text of Article 10.3 secures that the interests and rights of third parties are "fully taken into account during the panel process" (Article 10.1) in a manner enabling the Panel to "make an objective assessment of the matter before it" (Article 11.1). In the Panel's view, the object and purpose of Article 10.3 of the DSU is to allow third parties to participate in an informed and, hence, meaningful, manner in a session of the meeting with the parties specifically set aside for that purpose. Third parties can only do so if they have received all the information exchanged between the parties before that session. Otherwise, third parties might find themselves in a situation where their oral statements at the meeting become partially or totally irrelevant or moot in the light of second submissions by the parties to which third parties did not have access. Without access to all the submissions by the parties to the dispute to the first meeting of the panel, uninformed third party submissions could unduly delay panel proceedings and, as rightly emphasised by the EC and supported by Mexico, could prevent the Panel from receiving "the benefit of a useful contribution by third parties which could help the Panel to make the objective assessment that it is required to make under Article 11 of the DSU".[29]

2.35 The Panel therefore concludes that nothing in the DSU authorises this Panel to restrict the right of third parties to only receive the "first" submissions made on 4 May 2001, and to withhold from the third parties the rebuttal submissions due for 25 May 2001 (i.e. before the first meeting of the panel on 29-31 May 2001). The Panel decides that, pursuant to Article 10.3 of the DSU, third parties have the right to receive all written submissions "to the first meeting," including rebuttal submissions made before that first meeting. Accordingly, the Panel replaces the current sentence in paragraph 8 of its Working Procedures ("Third parties shall receive copies of the parties' first written submissions") by the text in Article 10.3 of the DSU: "Third parties shall receive the submissions of the parties to the dispute to the first meeting of the panel." The Panel notes that, pursuant to Article 12.1 of the DSU and paragraph 14 of its Working Procedures, the Panel can amend the Working Procedures after consulting the parties. The Panel considers that, having invited and received comments by the parties regarding the European Communities' request, it has duly consulted with them.

[28] The Panel notes that its Working Procedures were adopted consistently with past practice of Article 21.5 Panels.

[29] EC request for ruling, 18 May 2001.

## III. FACTUAL ASPECTS

*(i) Previous system*

3.1 Under the previous Canadian supply management system, introduced on 1 August 1995, a processor had to obtain a permit from the Canadian Dairy Commission (CDC), allowing it to buy milk under Special Milk Class 5(d) and (e). Class 5(e), referred to as "surplus removal", was made up of both in-quota and over-quota milk. Class 5(d) referred to specific negotiated exports including cheese under quota destined for the markets of the United States and the United Kingdom, as well as evaporated milk, whole milk powder and niche markets. The permit also specified the dairy products to be exported. The CDC only issued Special Milk Class 5(e) permits when all demand for milk in the domestic market was met. Once the processor had obtained the CDC permit, it approached the local marketing board, which made milk available to the processor at the regulated price and with a guaranteed margin. Prices for Classes 5(d) and (e) were negotiated and established on a case-by-case basis with the processors/exporters. The CDC conducted these negotiations in accordance with the criteria agreed upon in the Canadian Milk Supply Management Committee (CMSMC).

*(ii) Previous panel and Appellate Body judgements*

3.2 In its decision of 17 May 1999, the original panel in *Canada - Dairy* concluded that Canada "through Special Milk Classes 5(d) and (e) … has acted inconsistently with its obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture* by providing export subsidies as listed in Article 9.1(a) and Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule; … "[30] In its report of 23 September 1999 the Appellate Body upheld the findings in the original panel report with respect to Articles 3.3, 8 and 9.1(c) of the *Agreement on Agriculture.*[31] In respect of Article 9.1(a), the Appellate Body did not uphold the reasoning of the Panel, but it reserved its judgement on the question of whether Classes 5(d) and 5(e) conferred export subsidies within the meaning of Article 9.1(a).[32] The Appellate Body recommended that Canada bring those measures found to be inconsistent with its obligations under the *Agreement on Agriculture* into conformity with that agreement.[33] Canada's implementation of the Appellate Body ruling has resulted in the elimination of Special Milk Class 5(e) and the restriction of Class 5(d) to the export of dairy products within Canada's export subsidy commitment levels.[34]

*(iii) Canada's Implementation Measures*

3.3 In Canada, regulatory jurisdiction over the marketing and trade of dairy products is divided between the federal and provincial governments. Implementation of the recommendations and rulings of the DSB in *Canada-Dairy* therefore required action by the federal and provincial governments, and their agencies.

3.4 Milk destined for the commercial export market is referred to under federal regulations as commercial export milk or cream.[35]

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[30] Paragraph 8.1(a).

[31] *Canada - Dairy*, Appellate Body report, paragraph 144(b).

[32] *Id*., paragraph 144(a).

[33] *Id*., paragraph 145.

[34] Canada Gazette Part II, Vol.135, No.1: Regulatory Impact Analysis Statement for the Regulations under the Canadian Dairy Commission Act amending the Dairy Products Marketing Regulations. The amendment to section 7.1 "provides that export subsidies for Canadian dairy products will be provided only by a program established under paragraph 9(1)(i) of the CDC Act (Special Milk Class 5(d))." (Exhibit NZ-6)

[35] Canada Gazette Part II, Vol.135, No.1. (Exhibit CDA-1A)

3.5 Under the domestic supply management scheme, milk can be marketed either on the domestic market subject to a quota, or as Class 4(m) (animal feed) for any amount above the quota. Milk produced in Canada can also be pre-committed for sale outside the quota system and be sold to processors for export as commercial export milk (CEM). Regulations relating to health considerations and auditing continue to apply to export milk.

3.6 Pursuant to the *Canadian Dairy Commission Act*[36], the *Dairy Products Marketing Regulations*[37] have been modified to exclude commercial export milk and cream from federal licensing,[38] quota[39] and levy requirements[40] and from the requirement to market this milk through the provincial marketing boards. Furthermore, the milk delegation orders issued to provinces pursuant to *the Agricultural Products Marketing Act*, R.S.C. 1985, c. A-6, have been amended to remove provincial authority regarding commercial export milk or cream.[41] As a consequence of the changes made under *the Dairy Products Marketing Regulations* and the *Ministerial Direction*,[42] the regional pooling agreements (the P-9, P-6 and P-4 Agreements) do not apply to commercial export milk. The national pooling agreement, the P-9, provides for a domestic surplus management Class, Class 4(m).

*(iv) Regulatory Amendments at the Provincial Level*

3.7 As a consequence of the original Canada - Dairy panel and Appellate Body reports, legal frameworks in nine of the Canadian provinces have been modified to exclude export milk from the domestic management scheme.

3.8 In British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, and Prince Edward Island as well as in Ontario and Quebec, individual producers and processors participating in the commercial export market agree on the terms of commercial export transactions. The governments in Ontario and Quebec require that all export participants operate through a single commercial export exchange. These "bulletin boards" are part of the operational framework within which commercial export transactions take place.[43]

3.9 If milk is not marketed as CEM, it is domestic milk and accordingly subject to existing domestic regulations.

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[36] R.S.C. 1985, c. C-15 (Exhibit CDA-1C).

[37] SOR/94-466 (Exhibit CDA-1B). The Dairy Products Marketing Regulations were amended by *the Regulations Amending the Dairy Products Marketing Regulations*, C. Gaz. 2001.II.57 (Exhibit CDA-1A).

[38] *Supra*, note 31, s. 3(3) and s. 7.

[39] *Id.*, s. 4, 5 and 6.

[40] *Id*, s. 3(3).

[41] See Order Amending Milk Orders Under the *Agricultural Products Marketing Act*, SOR/2001-16, C. Gaz. 2001.II.67. (Exhibit CDA-1A)

[42] Published in Canada Gazette, 3 January 2001.

[43] For details of the pertinent legislation in the provinces, please see the exhibits referred to by Canada, New Zealand and the United States, respectively, in their submissions to the Panel.

## IV. MAIN ARGUMENTS

4.1 **New Zealand** and the **United States** claimed that the new measures' established by Canada, enable processors for export to obtain milk at prices that are lower than domestic prices, providing those processors with export subsidies within the meaning of Article 9 or of Article 10 of the *Agreement on Agriculture*. Accordingly, any exports of dairy products produced from milk accessed under Canada's new schemes must be within Canada's export subsidy reduction commitments. The complainants requested the Panel to recommend to the DSB that Canada bring its export subsidies into conformity with its obligations under the Agreement on Agriculture.

4.2 **Canada** requested that the Panel reject the claims of New Zealand and the United States and find that Canada's measures, including federal measures and the provincial measures of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia, New Brunswick and Prince Edward Island, fully implement the recommendations and rulings of the DSB and are thus consistent with Canada's WTO obligations.

### 1. Burden of proof

4.3 **New Zealand** submitted that as specified by Article 10.3 of the *Agreement on Agriculture*, Canada bears the burden of establishing that its dairy management measures, including those putatively taken to comply with the DSB's recommendations, have not subsidised dairy exports in excess of its commitment levels under that *Agreement.* Canada has demonstrably failed to meet this burden.

4.4 **Canada** responded that while Canada recognised the presence of Article 10.3, it noted that reports issued by panels and the Appellate Body under Article 21.5 of the DSU uniformly confirm that a Member's measure is presumed to comply with WTO obligations and, thus, any Member challenging that measure bears the burden of proof.[44] In any case, Canada's submissions provide more than sufficient evidence and legal arguments to show that it does not subsidise any quantities exported in excess of its export subsidy commitment levels.

4.5 **New Zealand** and the **United States** replied that none of the cases Canada cited dealt with the *Agreement on Agriculture* and Article 10.3. In cases involving the allegation that subsidisation in excess of export subsidy reduction commitments has occurred, Article 10.3 reverses the normal rule relating to burden of proof. The conclusion applies equally to cases brought under Article 21.5.

### 2. General

4.6 **New Zealand** noted that Canada has put in place new measures in substitution for the measures that were ruled in contravention of Canada's WTO commitments by the panel and Appellate Body in the original Canada - Dairy proceedings. Canada has developed schemes designed to continue the exportation of dairy products at previous levels by creating a new means of access to lower-priced milk for processors for export. The effect of these schemes is that Canada will continue to export subsidised dairy products in excess of its export subsidy reduction commitment levels. Canada has thus put in place measures that are not in conformity with the *Agreement on Agriculture* and is therefore in violation of its obligations under Article 21 of the DSU. Canada's implementation

[44] See, *e.g.*, *Canada - Aircraft*, Recourse to Article 21.5, paragraph 5.14; *Australia - Salmon*, Recourse to Article 21.5, paragraph 7.37; *EC - Bananas*, Recourse to Article 21.5 by the EC paragraph 4.13; *EC Bananas*, Recourse to Article 21.5 by Ecuador, paragraph 6.133 and n.225; *Brazil - Aircraft*, Recourse to Article 21.5, paragraph 66.

of the original ruling, New Zealand continued, has involved the elimination of Special Milk Class 5(e) and the limitation of the use of Class 5(d). Replacement measures have been adopted by Canada on a province-by-province basis.

4.7 New Zealand submitted that the new schemes have not eliminated an essential governmental presence and role. Federal and provincial governments have enacted the relevant amendments to existing regulatory schemes. They retain auditing functions over contracts between producers and processors and over exports by processors. The new schemes rest on the basic requirement, imposed by government, that milk surplus to the needs of the domestic market must be sold for export or not sold at all. Producers of such non-quota milk cannot sell into the domestic market, but are compelled to sell to processors for export. The effect of the creation of this separate market for non-quota milk is that processors for export can obtain milk at prices that are significantly lower than the price for milk sold on the domestic market with the sole proviso that the resulting product is exported.

4.8 In New Zealand's view, Canada's new schemes have implications for the exportation of dairy products from other countries. If Canada's schemes are allowed to stand, there will be no limit on the exportation of subsidised dairy products by countries with domestic supply management schemes, thereby undermining the export subsidy disciplines in the *Agreement on Agriculture*. The new dairy export mechanisms put in place by Canada all involve "payments on the export of an agricultural product, financed by virtue of governmental action" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. Alternatively, the schemes involve export subsidies "applied in a manner which results in, or which threatens to lead to, circumvention" of Canada's export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*. Hence, Canada continues to be in violation of Article 3.3 and Article 8 of the *Agreement on Agriculture.*

4.9 **The United States** submitted that while the programmes introduced in August 2000 are in some regards different from the Special Milk Class 5(e) which they replace, their objective, the provision of low priced milk to exporters to make dairy exports commercially viable, is precisely the same. The new programmes vary somewhat from province to province, but possess several common elements. Specifically, the provincial programmes allow exporters to purchase milk at prices that are below prevailing market levels for milk used in dairy products sold into Canada's domestic market. The low-priced milk made available to dairy processors and exporters can only be used to manufacture dairy products for export. Thus, the availability of such discounted milk is contingent on export. Furthermore, any person that diverts the low-priced milk, products made from it, or components of the milk, into Canada's domestic market faces severe sanctions.

4.10 Because Ontario and Quebec account for the vast majority (approximately 80 per cent) of dairy product exports from Canada, the United States has focused on the fundamental aspects of the provincial regimes that have been established there. There are four core elements to those provincial regimes. First, any milk produced above the level of the domestic quota must be sold for export-processing only (or relegated to use in the production of animal feed). The milk that is committed to export may not be introduced into the domestic market; such milk (or the resulting dairy products) must be exported. Second, the price paid by exporters for milk produced outside of the domestic quota is not regulated; this is in contrast to milk produced within the domestic quota, for which prices are specifically established by the provincial authorities. Third, any milk producer desiring to contract to provide milk for export must do so through a single, mandatory offer-and-acceptance process established by the provincial milk marketing board in conjunction with dairy processors in each province. Fourth, the export contracts are policed and enforced by the federal and provincial governments through a comprehensive array of mechanisms. While the contracts can be enforced by the private parties themselves, they are also subject to audit and enforcement by both provincial and federal authorities. For example, in Quebec a substantial monetary penalty is imposed on any entity diverting into Canada's domestic market any milk or milk products committed to an export contract.

4.11 The separate market for discounted export milk, the United States claimed, exists in all provinces solely by virtue of the government requirement that milk produced above or outside of domestic quota must be sold for export. By mandating the separation of the two markets, the Canadian government ensures that reduced price milk will be offered to processors for export. The producers have no real choice if they produce over-quota or without quota. They can either: (i) sell their milk into the export market for a lower price; (ii) sell their milk into the animal feed market under Class 4(m) for an even lower price which has been set by government; or (iii) destroy the extra milk which would have obvious political ramifications. The only real commercial option is to sell any over-quota or non-quota milk into the export market. By restricting the choice of the producer, the government enables the transfer of lower-priced milk to the processor. Absent these restrictions, the processor would have to pay the higher price applicable to milk for dairy products sold into the domestic market.

4.12 The government further secures the supply of discounted milk for the export market, the United States continued, by requiring that producers "pre-commit" their milk destined for the export market and that export milk must be delivered "first out of the tank." This ensures that, by law, producers cannot abandon their obligations to supply milk for export at a discount from the domestic price. These requirements further demonstrate that the export market is not a true commercial market but rather a contrived market created and controlled by the Canadian government. While creating the impression that producers are making a commercial decision to produce for the export market, these two requirements help ensure that export milk is not redirected into the domestic market. In reality, producers are doing exactly what they did under the Special Milk Class programme - arranging for the disposition of any milk not permitted to be sold in the domestic market

4.13 The CDC, the United States further submitted, also continues to play a central role in the export of dairy products. Although Canada has eliminated Special Milk Class 5(e), the CDC is still involved in the issuance of permits and the negotiation of milk prices for Class 5 (d) and 5(a), 5(b) and 5(c). Also, the CDC remains heavily engaged both in the operation of Canada's supply management system, as well as in the enforcement of the export mechanisms recently created by the provinces. For example, pursuant to section 10 of the federal regulations, the CDC possesses the authority to audit the books and records of both producers and processors to determine whether milk committed for export has in fact been exported. In addition, under new section 11(1), the CDC's inspectors have the authority to seize any dairy product that the inspector believes on reasonable grounds was marketed in inter-provincial or export trade in contravention of the federal regulations.[45]

4.14 **Canada** submitted that it has fully implemented the recommendations and rulings of the DSB in *Canada –Dairy* through federal measures and provincial measures in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Quebec, Nova Scotia, New Brunswick and Prince Edward Island. First, Canada has limited exports of dairy products manufactured with milk purchased under Special Milk Class 5(d) to Canada's export subsidy commitment levels and has abolished Special Milk Class 5(e) (surplus removal through exports). The function of surplus removal performed by Special Milk Class 5(e) has been replaced by measures internal to the domestic system. Second, federal regulations and regulations in nine separate provinces have been changed to eliminate government control over the commercial decisions by producers and processors to participate in the commercial export market. As a result of these regulatory changes, there are now two separate markets for milk in Canada: a regulated supply-managed market and an unregulated commercial export milk market.

4.15 Canada argued that the dairy regime has been fundamentally altered so that neither the CDC nor the provincial marketing boards can control commercial export transactions in the commercial

[45] "Regulations Amending the Dairy products Marketing Regulations", Canada Gazette Part II, Vol.135, No.1.

export milk market. Decisions to produce milk for the commercial export milk market are left to the sole commercial discretion of individual producers. Likewise, decisions to purchase this milk are left to the sole discretion of processors. The characteristics of the previous regime which were found by the panel and Appellate Body to give rise to export subsidies, Canada continued, no longer exist with respect to commercial export transactions. Due to regulatory changes at both the federal and provincial levels, among other things: (i) milk producers have complete freedom to independently allocate some, none or all of their milk to the commercial export market; (ii) producers do not need to hold quota to produce milk for the commercial export market; (iii) neither the CDC nor the provincial marketing boards determine when and what quantity of commercial export milk may be processed for export; (iv) individual producers and processors determine the sale price of commercial export milk; not the CDC or provincial boards; (v) processors do not have to obtain a permit form the CDC or appeal to the provincial marketing boards to obtain commercial export milk; (vi) the CDC does not negotiate or guarantee the processors' profit margins on sales of commercial export milk; (vii) provincial marketing boards do not regulate the collection of commercial export milk revenues from processors for payment to producers; (viii) there is no pooling of commercial export returns by government; and (ix) market forces, not governments, determine the effective selling price of commercial export milk.

4.16 The limited powers retained by the CDC and the provincial milk marketing boards, Canada continued, relate to licensing for the purpose of ensuring compliance with health, sanitary and quality standards and the post-transaction power to require the disclosure of records relating to milk utilisation and verification for the purpose of regulating and protecting the domestic market. There is nothing in these powers that enables the CDC or the provincial marketing boards to control commercial export transactions. Indeed the CDC is subject to clear and mandatory Direction from the Minister of Agriculture and Agri-Food stipulating that: "The Commission shall not act in any manner so as to influence, directly or indirectly, the terms, conditions or formation of contracts for the sale of commercial export milk or cream."

4.17 As a result of the implementation measures adopted by Canada, transactions for the sale of commercial export milk are *market driven at every stage* according to Canada. From the processor's determination of its volume and price requirements and issuance of an offer to purchase, to the decision by a producer to produce milk for the commercial export market, and his or her commitment under a contract to provide the milk, to the payment to the producer by the processor, these transactions are strictly a matter of private contract.

4.18 Canada submitted that processors make individual choices regarding the price that they are willing to pay for commercial export milk and the quantity of this milk that they wish to purchase, based on the commercial export business that they are able to secure. The prices offered for the milk are influenced by the prices at which the processors are able to sell their finished products, which are in turn influenced by international competition for these foreign sales, currency fluctuations and world-market conditions. In the deregulated commercial export milk marketplace, processors seek an assured supply of milk so that they can plan their export business, maximize revenue opportunities and respect their commitments to foreign buyers. Processors therefore seek commercial export milk supply commitments well in advance of production, and in some cases up to twelve months in advance. Referring to the United States arguments in paragraph 4.12, Canada submitted that pre-commitment does not provide, through governmental action, security of supply to processors. Security of supply is a function of the private contractual commitment by producers to deliver a specified volume of milk at a specified price.

4.19 Canada further contended that individual producers for their part, make production and marketing choices based on commercial grounds (i.e., on an allocation of sales to the two markets with a view to maximising revenue) and make calculated pre-planned production decisions. In

response to identified market opportunities, processors make offers to purchase commercial export milk in advance of production and producers decide whether to take up those opportunities and in what quantities. Referring to the complainants argument that producers produce milk beyond their quota and then enter into export contracts after the fact to get rid of this milk, Canada submitted that, on the contrary, the commercial practice of the dairy industry throughout Canada is that processors arrange their milk supply for export in advance of production. Pre-commitment and its corollary, the first milk out of the bulk tank principle, are the operational realities of contracted production.

4.20 Referring in particular to New Zealand's arguments in paragraph 4.8, Canada submitted that New Zealand is attempting to have the Panel establish new rules applying to two-price systems and their relationship to export subsidy commitments – rules that have not yet been the subject of agreement between WTO Members. Collapsing domestic support disciplines into export subsidy disciplines would have consequences extending far beyond the reach of the disciplines carefully negotiated by WTO Members and, therefore, should be rejected. The right to export while maintaining tariffs and domestic support was clearly built into the decisions incorporated into the results of the Uruguay Round. Any re-negotiation of WTO obligations is the responsibility of Members, and this is being pursued by Members in the current negotiations on agriculture.

4.21 **New Zealand** responded that a producer wishing to produce in excess of current quota must purchase quota if the milk is to go into the domestic market. But the total amount of quota is finite, and quota costs are substantial. Faced with such limitations, the producer who produces non-quota milk either has to negotiate a contract with a processor for export at a price less than the domestic market price or has to have the milk disposed of under Class 4(m). This is not the functioning of a voluntary, commercially-based market as Canada would have it. It is a case of individual producers making less than optimal choices because they are constrained by the regulatory system established and administered by governments. Accordingly, Canada's replacement schemes provide export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture.* But even if this is not the case, they nevertheless provide export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

4.22 **Canada** submitted further that the evidence clearly demonstrates that producers have a number of very real choices in the marketplace and manage their production based on the choices that they make. Evidence submitted by Canada illustrates the range of pre-production choices available to a producer, the quota and production management requirements associated with those choices and the post-production consequences of those choices. Producers are no longer required to hold domestic quota to produce milk in Canada. A producer, therefore, can choose not to hold domestic quota and can produce exclusively for the commercial export milk market. A producer can also choose to purchase or lease quota and sell into the domestic market. The data presented by Canada demonstrates there is an active commercial trade in quota.

4.23 Where a producer chooses to produce commercial export milk through a private contract with a processor, Canada argued, the producer decides how much of his or her production to allocate to this market and makes a contractual commitment to do so prior to producing the milk. It is then the responsibility of the producer to manage his or her production in order to meet the contractual commitment. Where a quota-holding producer does not want to sell into the commercial export market the producer can maintain production at levels within his or her quota range and will receive the Special Class 4(m) price for any production that exceeds that range (see paragraph 4.25 below).

4.24 Nothing prevents producers from producing milk and selling it to a processor under a commercial export contract instead of selling it into the regulated market, and nothing requires them to do so. Canada was of the view that if, as New Zealand and the United States suggested, producers were forced into the commercial export market by governmental measures, one would expect to see a

very high proportion of producers, if not all, participating in commercial export transactions but as of April, 2001, only about 30 per cent of Canadian producers had participated in commercial export contracts since deregulation measures were introduced in August 2000.

4.25 Canada considered that it has demonstrated that producers manage variations in production and respond to changes in quota levels within the flexibility provided by the administration of the domestic system. However, if in aiming to fill domestic quota, a producer over produces, the over-quota production cannot be sold into the commercial export market. Over-quota milk must be sold by the producer into the domestic system through internal pricing arrangements (at the Class 4(m) price of approximately $10 per hectolitre). About one half of Canadian producers have sold a small volume of milk at the Class 4(m) price. This small volume of sales (less than 1 per cent of total Canadian production) shows that producers are able to manage their production effectively so as to minimise the amount of milk that will be sold at this low price. The large number of producers selling at the Class 4(m) price demonstrates that this Class is effective in dealing with over-quota production and that producers do not and cannot divert over-quota milk into the commercial export market. Canada was of the view that if it were possible to sell over-quota milk on the commercial export market there would not be such a high degree of participation in Class 4(m).

4.26 **New Zealand** responded with respect to Canada's assertion in paragraphs 4.17 - 4.19 above that this is a misleading statement of the system under which the sale of milk for processing for export takes place. Given a real choice, producers would not sell to processors for export at all but rather in the higher priced domestic market. But that market is available only for milk produced under a government-set quota, and its existence protects processors for export from having to purchase milk at the higher domestic market price. Commercial export milk cannot be sold on the domestic market without "financial consequences", which are designed to "prevent the flow of commercial export milk into the domestic market, as admitted by Canada. This prohibition on the sale of non-quota milk on the domestic market results in the transfer of economic resources to processors for export that allows them to enter the international market.

4.27 As concerns the possibility of selling non-quota milk at the Class 4(m) price, in New Zealand's view the information presented by Canada (see paragraph 4.25), including the "small" volume of sales involved, confirms that Class 4(m) is not a realistic alternative for producers of non-quota milk. While producers may have been forced to use Class 4(m) in the past, the $10 per hectolitre average price received could not even cover a producer's marginal costs of production. This means that producers of non-quota milk are effectively compelled by governmental action to sell, at a price discount, to processors for export. New Zealand was of the view that the economic incentives that govern Canada's "commercial export milk market" are not the prices offered by processors for export, but the requirement that non-quota milk be sold for export. The commercial export milk market is ancillary to the domestic system and its existence is completely dictated by the constraints in that system. It is an artificial market which would not exist if individual producers were allowed to choose where they place their production.

4.28 With respect to Canada's claim that the notion of "surplus milk" no longer applies to the milk sold under export contracts, New Zealand submitted this is a matter of words, not substance. The fundamental nature of the system has not changed. The milk that producers now have to pre-plan and pre-commit is still "surplus milk" in the sense that it is deemed to be surplus to the needs of the domestic market. The way in which processors for export gain access to milk has not changed in its fundamental respects. Canada's replacement schemes still provide processors for export with access to lower-priced milk than that available in the domestic market. These schemes continue to constitute an export subsidy under Article 9.1(c) of the Agreement on Agriculture. Alternatively, they violate Article 10.1 of that Agreement.

4.29 New Zealand contended that Canada does not address the consequences for the agricultural trading system if its view were to be accepted. Export subsidies are fundamentally a means used by governments to maintain domestic prices at levels higher than world prices. The existence of a price difference is, therefore, an indicator that an export subsidy may exist, even if it is not the only element needed to establish an export subsidy. It is not possible to ignore the comparator domestic market when looking at whether an export subsidy exists under Article 9.1. Canada claims that its creation of separate "markets" with producers acting "commercially" in each means that the price difference somehow disappears. But the implications of such an argument are clear. A government could claim no export subsidy existed by simply creating in law a separate "market" for export with lower prices than those in the domestic market.

4.30 The **United States** submitted that cost of production data used to set prices in the domestic system contradict the claim in Canada's first submission that farmers freely supply this milk based on normal commercial factors. According to data from the official cost of production survey, less than 30 per cent of Canadian farmers cover their cost of production at an average price of C$57.41/hl and less than 1 per cent could cover costs at export market prices of around C$30/hl. Why would the average farmer choose to produce for this market?

4.31 As concerns the complainants arguments with respect to the cost of production and the price at which the milk is sold in the commercial export market, **Canada** submitted that the relevant facts show that profitable participation in the commercial export milk market is feasible for many producers. Furthermore, Canada considered that it has demonstrated that the CDC and provincial marketing boards have no role in individual producer and processor decisions to participate in the commercial export milk market and thus cannot be said to be compelling producers to sell their milk under commercial export contracts. Although the precise details of how each provincial industry now operates vary, they share a crucial feature: producers and processors decide, free of government control, whether to engage in commercial export transactions, the volume of milk to commit to produce and the price for the milk. As in any private contract, the responsibilities for enforcing the contractual obligations rest with the parties to the transaction (i.e., the producer and the processor).

4.32 In British Columbia, Alberta, Saskatchewan, New Brunswick, Nova Scotia and Prince Edward Island, Canada continued, terms and conditions regarding commercial export contracts are agreed to directly and privately between producers and processors. In Manitoba, Ontario and Quebec, export contract offers and acceptances are communicated through commercial exchanges using electronic bulletin boards. The exchange format allows processors to post contract offers to which producers respond by phone. The results or confirmations are then posted on the web site. The exchanges are administrative constructs operated by independent, reputable, private firms and are particularly effective in provinces with market places having numerous participants. In Manitoba, processors and producers can also contract directly and there is nothing to preclude the establishment of other bulletin boards.

4.33 **New Zealand** responded with respect to Canada's arguments in paragraph 4.32, that governmental action remains indispensable to the transfer of economic resources from producers to processors for export because the decision to produce milk for export is a decision that is dictated by the fact that milk for the domestic market is regulated by quota. The decision to sell is equally trammelled. No profit-maximising producer would sell into the commercial export milk market in the absence of the prohibition against selling non-quota milk into the domestic market. This prohibition is by virtue of governmental action. Equally, the decision of a processor for export to purchase milk in the commercial export milk market is a product of governmental action. In the absence of a prohibition on the selling of non-quota milk into the domestic market, a processor for export would only be able to access milk from the higher priced domestic market.

4.34 The **United States** submitted that the fundamental obligation of the *Agreement on Agriculture* concerning export subsidies is contained in Article 8, which provides that: "Each Member undertakes not to provide export subsidies other than in conformity with this *Agreement* and with the commitments as specified in that Member's Schedule." Article 3.3 of the *Agreement*, in turn, provides that a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in excess of the budgetary outlay and quantity commitment levels specified in Section II of Part IV of that Member's Schedule. To ensure, moreover, that the disciplines on export subsidies contained in Article 3.3 are not circumvented, Article 10.1 of the *Agreement* directs that any export subsidy not identified in Article 9.1 may "not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments . . ." Thus, a Member may use export subsidies not listed in Article 9.1 only within the limits of its scheduled reduction commitments.

4.35 Given this framework, the United States continued, any export subsidy that falls either within the scope of the export subsidy descriptions contained in Article 9.1 or within the broader reach of Article 10.1 of the *Agreement* is subject to the limitations, both budgetary and quantitative, included in each Member's Schedule. The United States considered that Canada's provincial export measures are export subsidies within the meaning of Article 1(e) of the *Agreement* and, therefore, must be confined within the quantitative limits prescribed in Canada's Schedule. Canada's failure to respect its Schedule limitations on export subsidies is, in turn, a failure to comply with the DSB's recommendations to bring its milk export subsidies into conformity with the *Agreement*.

**3. Article 9(1)(c) of the Agreement on Agriculture**

*(i) "payments"*

4.36 **New Zealand** and the **United States** submitted that two elements are required in order to establish the existence of an export subsidy under Article 9.1(c). First, there must be a "payment", and second, that payment must be "financed by virtue of governmental action".

4.37 In the original Canada – Dairy proceeding, **New Zealand** submitted, the Appellate Body held that the term "payments" "denotes a transfer of economic resources." In the Appellate Body's view, whether "payments" had been made in the context of Special Milk Classes 5(d) and 5(e) depended upon whether processors for export were obtaining milk at prices that were discounted from the prices that applied in the domestic market.[46] New Zealand considered that this reasoning applies equally to Canada's new measures. Milk continues to be available to processor for export at prices that are lower than domestic market prices.

4.38 The **United States** submitted that the new provincial export schemes fulfil both of the conditions set forth in paragraph 4.36 above and, thus, constitute Article 9.1(c) export subsidies. The Appellate Body articulated the standard for determining whether a "payment" exists as follows:

> If goods or services are supplied to an enterprise, or a group of enterprises, at reduced rates (that is, at below market-rates), "payments" are, in effect, made to the recipient of the portion of the price that is not charged. Instead of receiving a monetary payment equal to the revenue foregone, the recipient is paid in the form of goods or services. But as far as the recipient is concerned, the economic value of the transfer is precisely the same.[47]

[46] *Canada - Dairy* , Appellate Body report, paragraph 107.
[47] *Canada - Dairy*, Appellate Body report, *supra* note 1, paragraph 113.

4.39 Under the new provincial programmes, the United States continued, the export contract prices offered are significantly below the market prices paid for milk entering Canada's domestic market for final consumption. For example, the average price for Class 3 milk sold into the Canadian market for ultimate consumption within Canada was about C$56 per hectolitre for the period August to December 2000, i.e. about 85 per cent above the price offered in export contracts reported for the same month. Thus, just as in the case of the earlier Special Milk Class system, the new provincial export measures result in milk producers providing milk for export at a substantial discount to the prevailing market price for milk delivered for ultimate consumption in Canada. Milk producers are now foregoing revenue in the same manner that the original panel and Appellate Body found to constitute a "payment" for purposes of Article 9.1(c) under the Special Milk Class system.

4.40 **Canada** responded that the complainants arguments disregard the finding of the Appellate Body on what constitutes a 'payment' under Article 9.1(c). The Appellate Body held that "[i]f goods or services are supplied to an enterprise, or a group of enterprises, at *reduced rates* (that is, at below *market rates*), 'payments' are, in effect, made to the recipient of the portion of the price that is not charged".[48] The corollary of this proposition, Canada continued, is that where the recipient of goods or services pays market-rates or market value[49] for those goods or services, there can be no "payment" under Article 9.1(c)[50] as no "advantage" or "benefit" is conferred on the recipient.[51] Sales at fair market value through arm's length transactions in a private commercial context cannot be considered to confer a benefit.[52]

4.41 Applying the facts to the text of the *Agreement on Agriculture*, Canada continued, there is no export subsidy provided to processors within the meaning of Article 9.1(c) of the *Agreement on Agriculture.* There are no "payments" on the export of dairy products manufactured with commercial export milk, since commercial export milk is sold *at*, not *below* market rates. Even if "payments" were provided to processors in commercial export transactions, an export subsidy would not exist because those "payments" would not be financed by virtue of governmental action.

4.42 **New Zealand** responded that Canada's whole argument rests on the assumption that its commercial export milk market can be considered in isolation from its domestic market. But the so-called commercial export milk market exists only because of the ban of non-quota milk from the domestic market. Processors for export receive a transfer of economic resources because they are able to access milk at a price that would not be available to them if producers were permitted to sell non-quota milk into the domestic market. In the absence of any requirement that producers sell non-quota milk into the "commercial export milk market", processors for export would have to purchase their product from the domestic market at the higher domestic price. The implication of Canada's argument would be that governments that were not permitted to make payments directly to processors for export, nor were entitled to do so by the provision of payments-in-kind or revenue forgone, could provide such payments indirectly by effectively forcing producers to sell milk for export into a separate "export market" at a lower price.

4.43 The **United States,** responding to the arguments by Canada in paragraph 4.56 above, argued that these arguments should be rejected because the original panel did not consider the *SCM Agreement* in analysing Article 9.1(c) of the *Agreement on Agriculture.* It was only when pondering

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[48] *Id*. (emphasis added).

[49] "Market-rate" and "market value" are synonymous. See the *New Shorter Oxford English Dictionary* (Clarendon Press: Oxford, 1993) page 1699.

[50] See also *Canada-Dairy*, Appellate Body report, *supra* note 1, paragraph 107.

[51] See also *Canada-Dairy*, Appellate Body report, supra note 1, paragraph 87. This reasoning equally applies to Article 9.1(c). See *Canada - Dairy*, Appellate Body report, *supra* note 1, paragraph 107.

[52] See for example, *United States –Hot-Rolled Lead and Carbon Steel*, paragraphs 72-74.

the claim under Article 10.1 of the *Agreement on Agriculture* that the panel considered the *SCM Agreement* as *context* and then the panel determined that it was more appropriate to analyse paragraph (d) of the Illustrative List of Export Subsidies than to analyse the general concepts of Article 1 of the *SCM Agreement.* As well, Canada's interpretation of Article 9.1(c) is not supported by the language of the agreement itself or the negotiating history cited by Canada.

4.44 **Canada** submitted that whether or not there exists "payments" on the exports of agricultural products must be determined in the light of the prevailing market conditions. At the time of the findings of the original panel and Appellate Body, there was only one market for milk in Canada: a regulated market. Government set the prices of all milk under this market. It is in light of these market conditions that the difference between the domestic and the export price was found to constitute a "payment" under Article 9.1(c).

4.45 The market conditions which presently exist are completely different, Canada contended. Hence the fact that there exists a difference between the export price and the regulated domestic price is, in Canada's view, irrelevant. Producers and processors now have access to two markets: a regulated market and a commercial export market. Market forces, not government, now determine the price at which commercial export milk is purchased and sold. More particularly, the price at which commercial export milk is bought and sold reflects the price at which the seller (a private producer) is ready and willing to sell and a buyer (the private processor) is willing to buy. The prices are determined through mutual agreement, without regulatory control or compulsion of any kind. Processors are not paying less than adequate remuneration for commercial export milk. Rather, they are paying prices determined by the competitive forces of supply and demand in international markets. Moreover, Canada noted that New Zealand conceded that commercial export milk prices were global or world market prices. For these reasons, there are no "payments" on the exports of dairy products manufactured with commercial export milk. Canada therefore considered that since the first element of Article 9.1(c) has not been met, there is no violation of this export subsidy discipline.

4.46 **New Zealand** submitted that the Appellate Body did not hold that since government no longer sets prices in its export market, somehow this means the difference in prices between the export market and the domestic market is no longer relevant. Instead it held that the provision of lower-priced milk constitutes a payment. It did not say that the lower price has to be set by government. Canada's argument is based on a confusion between the question of whether lower-priced milk is made available and the question of whether this is done by virtue of governmental action. The first question under Article 9.1(c) is one of fact – are "payments" being made, that is, is lower-priced milk being provided? It is not a question of whether government is setting prices. The answer to the first part of this question is self-evident. The price for milk paid by processors for export is substantially less than the price paid for milk accessed in the domestic market. That fact is not denied by Canada, and it constitutes a payment within the meaning of Article 9.1(c). Furthermore, such a transfer of economic resources from producers to processors is provided by virtue of governmental action, because producers of non-quota milk cannot sell their milk into the domestic market at domestic market prices. That prohibition results from the action of governments.

4.47 The **United States,** referring to Canada's arguments in paragraphs 4.40 and 4.45 above, responded that Canada's approach to analysing whether a "payment" is conferred assumes that the appropriate benchmark is the export market price. However, this approach is inconsistent with the legal standard that the Appellate Body and the original panel in this case applied in determining the existence of a subsidy under Article 9. In determining whether a "payment" is made within Article 9.1(c), the United States considered that this Panel must assess what would have been *otherwise available* to processors/exporters in the market-place. For all practical purposes, the only source of milk otherwise available to Canadian processors/exporters is milk produced *in* Canada. And that milk

is sold at a high price pursuant to regulation (unless, of course, the milk is destined for export). Just as in the case of the Special Milk Class 5(e) scheme, the processor is accessing milk for export at a price that is lower than would be paid by the same processor purchasing the same milk for use in manufacturing dairy products destined for the domestic market. Likewise, producers are providing milk for export at a substantial discount to the market price for milk delivered for domestic consumption.

*(ii) "financed by virtue of governmental action"*

4.48 **New Zealand** considered that, in the present case, Canada's new measures equally meet the test of whether "governmental action" is "indispensable"[53] to the transfer of resources that amounts to a "payment". Canada's new schemes provide milk to processors for export at prices lower than domestic prices because of the requirement that 'non-quota' milk be sold for export. It is the governmental segregation of the 'market' for export milk from the domestic market that allows processors to access milk at prices that are lower than domestic prices. The Appellate Body held that "payments" were "financed by virtue of governmental action" because the "governmental action" in question was "indispensable to the transfer of resources that takes place as a result of the operation of Special Milk Classes 5(d) and 5(e)."[54] The standard was whether processors for export would be able to gain access to milk at prices lower than those available on the domestic market in Canada were it not for the actions of the Canadian government or its agencies.

4.49 If Canadian governments and their agencies did not make a distinction between "domestic" and "export" markets, New Zealand continued, processors for export would not have access to lower-priced milk for export production. They would simply have access to milk available on a single Canadian market at whatever price was current in that market. It would be up to processors to decide whether to sell the resultant product domestically or for export. No export subsidisation would be involved. As a result, the new Canadian measures clearly provide "payments on the export of an agricultural product financed by virtue of governmental action" within the meaning of Article 9.1(c) of the *Agreement on Agriculture.* Such subsidies are subject to Canada's reduction commitments.

4.50 With regard to the analysis of the second prong of Article 9.1(c), the **United States** submitted, it is clear from a review of the government's involvement that the payments to the processors under the provincial export programmes are made by "virtue of governmental action." There are three primary indicia of the government's involvement in the new provincial export programmes. These include: (i) the fact that Canada artificially segregates the market for milk that is exported and milk that is consumed domestically; (ii) that provincial regulations require that any milk committed for export contracts through the new export schemes be exported, and that the federal and provincial governments have sanction authority to enforce this requirement; and (iii) that in Ontario and Quebec all milk destined for export must be sold through an exclusive mandatory bulletin board system.

4.51 Furthermore, the United States argued, the panel in the original proceeding recognized the role of the domestic quota system in the transfer of resources from the producer to the processor under the Special Milk Class system as "government action" within Article 9.1(c).[55] Its analysis of this issue is directly applicable to the role of the domestic quota system and hence the government under the new provincial export programmes. In sum, the United States submitted, Canada has not refuted that the overall action of Canadian governments in establishing domestic production quotas, in excluding over-quota and non-quota milk from the domestic market, in exempting export contract milk from

[53] *Canada - Dairy*, Appellate Body report, paragraph 120.
[54] *Id.*
[55] *Canada - Dairy*, panel report, paragraph 7.100.

domestic pricing requirements, in instituting mandatory and exclusive export contracting mechanisms, and in enforcing the various obligations arising from these regulatory requirements, constitutes pervasive government intervention. It is only through the exercise of these government powers that exporters are provided milk at discounted prices. Not only is government action involved, but it is indispensable. Accordingly, the requirement under Article 9.1(c) that payments are financed "by virtue of government action" is satisfied in this case.

4.52 The United States contended further that Canada insists that there must be a "direct connection" or there must be evidence that the government has "affirmatively instructed or directed someone to provide a financial contribution" under Article 1.1(a)(1)(iv) and that this standard must be satisfied to fall within Article 1 of the *SCM Agreement* and therefore Article 9.1(c) of the *Agreement on Agriculture*. This interpretation is, in the opinion of the United States, not legally sound as it ignores the phrase "by virtue of" in Article 9.1(c) which suggests an indirect connection and essentially writes the language in paragraph (d) of the Illustrative List referring to the provision of subsidies "indirectly" through "government mandated-schemes" out of the *SCM Agreement.*

4.53 Finally, with respect to Canada's reference to the negotiating history, the United States submitted that under the Vienna Convention on the Law of Treaties, negotiating history should only be considered if the plain meaning of the text is ambiguous. Canada has not established this and, indeed, it is not. In any event, a review of the negotiating history does not strengthen Canada's arguments. The quote referred to by Canada[56] simply supports the principle that it is the extent of government action that is important. The United States agreed and believed that it had established that government action is indispensable to the payment to the exporters in this case.

4.54 **Canada** submitted that even if "payments" were found to exist, they would not be financed by virtue of governmental action. All of the factors relied upon by the original panel and Appellate Body related directly to the determination of the volume of milk for export or to decisions regarding prices, including the pooling of revenues.[57] Each involved some form of affirmative or positive action on the part of governments or their agencies by virtue of which the payments were financed. As the panel in *Canada-Dairy* reasoned, the existence of parallel markets for domestic use and for export with different prices does not necessarily constitute an export subsidy. What is key is the government involvement in providing the "payment". In particular, there must be a direct connection between the "governmental action" on the one hand and the "payments" on the other. Governments need not be the actual source of the funds. However, the financing must be by virtue of governmental action, as opposed to commercial decisions by private individuals or companies. The very text of Article 9.1(c) provides an illustration of this point. The financing need not involve a "charge on the public account". However, as shown by the example of a mandatory levy "imposed" on an agricultural product, in Canada's view, the financing of the payment must be directly connected to

[56] "[T]here was no doubt that there was an obligation to notify all schemes of levy/subsidy affecting imports or exports in which the government took a part either by making payments into the common fund or by entrusting to a private body the functions of taxation and subsidisation with the result that the practice would in no real sense differ from those normally followed by governments. In view of these considerations the Panel feels that the question of notifying levy/subsidy arrangements depends upon the source of the funds and the extent of government action, if any, in their collection." Panel report, *Review Pursuant to Article XVI:5,* BISD, 9S/189.

[57] For instance, after describing the mandatory pooling arrangements in respect of Class 5(d) and the more limited form of pooling in respect of Class 5(e), the Appellate Body described these arrangements as involving "governmental action" that remains an essential aspect of the financing of "payments" to processors. *Canada - Dairy*, Appellate Body report, *supra* note 1, paragraph 121.

"governmental action". The ordinary meaning of the words "by virtue of"[58] also support this proposition.

4.55 The complainants, Canada continued, had not demonstrated this connection, and therefore argued that measures relating to the regulated market effectively force producers to provide commercial export milk to processors. Canada submitted that no support for such a test can be found in either the findings of the original panel or of the Appellate Body. Nor can any support be found in the ordinary meaning of the words under Article 9.1(c), interpreted in their context and in the light of their object and purpose, or in the negotiating history of Article 9.1(c) and other export subsidy disciplines.

4.56 In this respect Canada submitted that the words in Article 9.1(c) must also be read in light of basic subsidy principles and disciplines that both the *Agreement on Agriculture* and the *SCM Agreement* contain. Canada's interpretation of Article 9.1(c) is informed by the important context provided in the *SCM Agreement.* Under Article 1.1(a)(1)(iv) of the *SCM Agreement*, an "indirect subsidy" arises when governments affirmatively instruct or direct someone to provide a financial contribution, for example in the form of goods. There must be an affirmative action of delegation or command on the part of government. Absent this, there is no government action and no subsidy. Since no such governmental action exists in Canada with respect to CEM, there can be no subsidy under Article 9.1(c) of the *Agreement on Agriculture.* Canada considered that its interpretation is confirmed by the negotiating history of Article 9.1(c) which contemplates that "indirect subsidies" exist when governments instruct or direct someone else to provide a financial contribution that they would normally provide themselves.

4.57 Canada submitted that it had removed any possibility of any payments "financed by virtue of governmental action". In particular, the CDC and provincial marketing boards have no authority over the decision to produce, purchase or sell commercial export milk. They do not set the price of commercial export milk nor do they control processor margins or pool revenues, impose quantitative limits, issue transaction-specific permits, calculate returns or dictate means of payment in commercial export transactions. In short, commercial export transactions have been deregulated.

4.58 **New Zealand** responded that Canada misconstrues the clear wording of Article 9.1(c), and confuses the requirement that there be a "direct subsidy" under Article 9.1(a) with the requirement that the "payment" must be financed "by virtue of" governmental action under Article 9.1(c). The word "direct" stands in contrast to the phrase "by virtue of" which is not confined to a relationship that is "direct". If the drafters of Article 9.1(c) had intended the connection between "governmental action" and "payment" to have been "direct", they would have used words that provided that meaning and not the more generic phrase "by virtue of".

4.59 **Canada** submitted that as a result of its deregulation, the factors relied upon by the original panel and Appellate Body to find "governmental action", all of which involved some form of positive action on the part of government, have been eliminated with respect to commercial export transactions. According to Canada, governments do not provide commercial export milk to processors, nor have they mandated that someone else provide commercial export milk to processors in their place. Licensing and auditing do not constitute financing by virtue of governmental action. These activities have nothing to do with the decision to produce, sell or purchase milk for commercial export markets. Similarly, the fact that in certain provinces commercial export transactions must be concluded on a bulletin board does not meet the test under Article 9.1(c), as producers in these provinces also decide of their own volition whether or not to provide commercial export milk to

[58] *Black's Law Dictionary*, *supra* note 88, page 201, defines "by virtue of " as follows: "[b]y force of, by authority of, by reason of."

processors. Whether or not Canada's measures prohibit, penalise or impede the diversion of commercial export milk into the domestic market is also irrelevant to the question of the existence of an export subsidy. Those measures are maintained to support or protect the regulated market, not to support, force or mandate exports.

4.60 **New Zealand** responded that whether the prohibition to sell export contract milk into the domestic market results from a directive with a formal sanction imposed at either the federal or provincial level, or whether it results from financial consequences for the processor who diverts milk under a commercial export contract into the domestic market, the result is the same. There is, effectively, a prohibition on the sale of non-quota milk into the domestic market.

4.61 **Canada** submitted that the ordinary meaning of the words "by virtue of" does not support the positions of New Zealand and the United States. "By virtue of" means "by force of, by authority of, by reason of". Governments must therefore direct or require the provision of goods. Governments have done no such thing with respect to commercial export milk. Rather, producers voluntarily choose to provide commercial export milk to processors. Canada considered that the complainants erroneously present as direct action the very actions necessary to deregulate the export market and measures to ensure health and safety standards for all milk and auditing of the regulated market. Given the absence of direct governmental action, Canada continued, their efforts must fail because they present no evidence of impermissible government action – direct or indirect.

4.62 Canada considered the assertion by the complainants that, by precluding the sale of commercial export milk into the domestic market, Canada effectively forces producers to provide processors with commercial export milk as incorrect. First, producers *choose* to produce for this market, just as they choose to produce for the regulated market. Second, an export subsidy is not defined by the *effects* of government measures related to the domestic regulated market. The complainants' assertions are not based on the legal standards that actually exist in either the *Agreement on Agriculture* or the *SCM Agreement.* In Canada, government does not provide commercial export milk to processors, nor does it instruct or direct producers to provide this milk to processors or mandate that they do so.

4.63 **New Zealand** responded that Canada's reliance on the ordinary meaning of the words "by virtue of" is unduly selective. Canada ignores one of the meanings given – "by reason of". In the view of New Zealand, such an extrapolation bears no relation to the dictionary definitions provided for either in *Black's Law Dictionary*, or in the *Oxford English Dictionary*, which indicates that it means "by the power or efficacy[59] of (something aiding or justifying); hence, in later use, by the authority of, in reliance upon, in consequence of, because of",

### ~~4.~~ Article 10.1 of the Agreement on Agriculture

4.64 **New Zealand** and the **United States** submitted that even if the new Canadian measures did not provide export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, they nevertheless provide export subsidies within the meaning of Article 10.1 of that Agreement. **New Zealand** considered that the first part of this Article requires two elements to be established: there must be "export subsidies not listed in paragraph 1 of Article 9"; and those export subsidies must be "applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments." Alternatively, if it can be shown that "non-commercial transactions" have been used to circumvent export subsidy commitments, this too will constitute a violation of Article 10.1. Measures which meet some but not all the definitional elements of the individual export subsidy practices listed in Article 9.1 would be covered by Article 10.1, provided that they meet the

[59] Exhibit NZ-27.

basic requirement of Article 1(e) of the *Agreement on Agriculture* that they are "subsidies contingent upon export performance".

4.65 The product that is sold to processors for export under Special Milk Classes 5(d), **New Zealand** submitted, and the product that is sold to processors for export under Canada's replacement schemes is identical. In each case, processors for export are provided with access to lower-priced milk. In the one case, Canada recognises that the exported product is subsidised and keeps it within its export subsidy reduction commitments. In the other case, Canada claims that the exported product is not subsidised and that it is entitled to exclude it from its reduction commitments. However, a measure that mirrors in all respects a measure that provides an export subsidy and is treated as such by Canada under Special Milk Classes 5(d), must itself be an export subsidy.

4.66 The drafters of Article 10.1, New Zealand submitted, were trying to capture measures that did not technically fall within the definitions of Article 9.1, but which had the same economic effect as measures that did. A key element of the subsidisation that occurs in this case relates to the price difference between the domestic market and the so-called "commercial export milk market". The relevance of price differences in establishing the existence of an export subsidy is noted particularly in Article 9.1(b) of the *Agreement on Agriculture*. The presence of a price difference becomes, in a sense, a "warning factor" of the existence of an export subsidy.

4.67 The **United States** referred to the Appellate Body which stated in the *United States - FSC* case that the obligations under Article 10.1 come into play when three factors are present: (i) there is a subsidy not identified in Article 9.1 of the *Agreement*, (ii) that subsidy is contingent on export, and (iii) the subsidy results in, or threatens to lead to, circumvention of a Member's export subsidy commitments. The Appellate Body has drawn upon the definition of a "subsidy" in the *SCM Agreement* as context for construing that same term for purposes of the *Agreement on Agriculture.* A subsidy arises where the grantor makes a "financial contribution" which confers a "benefit" on the recipient as compared with what would have been otherwise available to the recipient in the marketplace.[60]

4.68 Here, the United States continued, exporters obtain milk on a discounted basis, at a lower price than would otherwise be available to them in their domestic market, which is, practically speaking, the only market for milk in Canada. The exporters thus receive a benefit comprised of the cost savings resulting from the availability of lower priced milk. Second, it is undisputed that the availability of discounted milk is dependent on use of the milk in the manufacture of dairy exports. Thus, it is a subsidy contingent on export. Third, the subsidy results in, or threatens to lead to, the circumvention of Canada's reduction commitments. Because there is no constraint on the availability of the export subsidy created by the new export schemes, those export subsidies are unlimited in scope as are the exports they foster.

4.69 **Canada** noted that the *Agreement on Agriculture* does not define the term "subsidy". However, as the Appellate Body has indicated in the *United States - FSC* report,[61] the definition of "subsidy" in Article 1.1 of the *SCM Agreement* provides important contextual guidance in defining the scope of an "export subsidy" under Article 1(e) of the *Agreement on Agriculture*.[62] Both the United States and New Zealand implicitly recognize this in their submissions.[63] In assessing whether Canadian measures fall under Article 10.1 (*i.e.*, whether there is a transfer of economic resources and

[60] *United States - FSC*, Appellate Body report, paragraph 135-154.
[61] *United States – FSC*, Appellate Body report, paragraph 136.
[62] *Id.*
[63] Submission by New Zealand, paragraph 7.28 and Submission of the United States, paragraph 96.

whether that transfer involves a benefit to the recipient[64]), reference is therefore made to the definition of a "subsidy" under the *SCM Agreement*. As such, the definition of "subsidy" under the *SCM Agreement* consists of two discrete elements: (i) a financial contribution by a government ; and (ii) conferral of a benefit thereby. [65] The nature of the government action, Canada continued, is determinative as to whether a "financial contribution" exists under Article 1.1(a)(1). If a government has not acted in a manner enumerated in Article 1.1(a)(1), then a "financial contribution" does not exist and there can be no "subsidy". As stated before, Canada's measures adopted to implement the recommendations and rulings of the DSB do not provide "subsidies" within the meaning of Article 1.1(a)(1)(iii) or (iv). Furthermore, since there is no subsidy and no export subsidy involved in commercial export milk transactions, there can be no circumvention of Canada's export subsidy commitment within the meaning of Article 10.1 of the *Agreement on Agriculture*.

4.70 **New Zealand** noted that to "circumvent" means to "find a way round" or "evade". A Member finds a way around or evades its obligations if it transfers by another means the very economic resources that it would be prohibited from providing in another form under Article 3.3 and Article 9.1 of the *Agreement on Agriculture*. In the view of New Zealand, Canada has done precisely this. Through the combined exercise of federal and provincial authority, mechanisms have been established to provide processors for export with lower-priced milk. Equally, where a Member has taken measures that will enable the export of subsidised products in excess of reduction commitments, those measures threaten to lead to circumvention, even though no quantities in excess of reduction commitments may have yet been exported. New Zealand further noted that Article 10.1 also provides that non-commercial transactions shall not be used to circumvent export subsidy commitments. A non-commercial transaction is one in which private profit-maximising individuals would not, from choice, engage. In the present case, the market in which these transactions take place is completely constructed. Producers of non-quota milk are compelled to sell to processors for export. Such are thus "non-commercial transactions" within the meaning of Article 10.1[66].

4.71 New Zealand considered that Canada has failed to meet the burden of showing that no export subsidies within the meaning of Article 10.1 have been provided and thus Canada is circumventing its export subsidy commitments. Referring to Canada's argument that as a result of the Import for Re-Export Program access to imported milk is unrestricted and depends on commercial considerations only, New Zealand contended that Canada does not answer the concerns expressed by the Panel, such as the fact that permits under the programme are discretionary and that volumes imported suggest that terms of access are less favourable.

4.72 **New Zealand** and the **United States** were of the view that the export subsidy provided by Canada's replacement schemes falls within the definition of export subsidy contained in paragraph (d) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement*. The *SCM Agreement*, the complainants submitted, is relevant to determining the meaning of "export subsidy" in Article 10.1. Specific guidance can be obtained from paragraph (d) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*. The new Canadian dairy exporting schemes fulfil all of the elements of paragraph (d): first, dairy processors continue to have access to milk through the electronic export contract bulletin boards which is priced on more favourable terms than would otherwise be available to such processors for milk in the domestic market; second there has been the provision of a product "for use in the production of exported goods, on terms more favourable than for provision of like or directly competitive products … for use in the production of goods for domestic consumption" as the price for export milk is much lower than that for milk to be sold for domestic

[64] *United States – FSC*, Appellate Body report, *supra* note 107, paragraph 137.
[65] *Canada –Aircraft*, panel report, paragraph 156. See also *Brazil –Aircraft*, Appellate Body report, paragraph 157.
[66] Submission by New Zealand, paragraphs 7.43 to 7.47.

uses; third, the lower-priced milk has been provided "by governments or their agencies directly or indirectly through government-mandated schemes" as it is made available to processors for export as a result of the prohibition, imposed and enforced by government, on the selling of non-quota milk into the domestic market; and fourth, the terms and conditions on which milk is made available for processors for export are more favourable than those available to them on world markets. Therefore, New Zealand and the United States continued, the Canadian schemes provide "subsidies" within the meaning of Article 1 of the *SCM Agreement*, and hence are "export subsidies" within the meaning of Article 10.1 of the *Agreement on Agriculture* as they are subsidies "contingent upon export performance".

4.73 **Canada** reiterated that since governments do not affirmatively instruct or direct producers to provide commercial export milk to processors, no "subsidy" exists such as under Article 1.1(a)(1)(iv) of the *SCM Agreement*. Nor are governments providing a "subsidy" in a manner such as that described under Article 1.1(a)(iii) of the *SCM Agreement*, which contemplates a direct provision of goods by government. Applying the facts to the text of the *SCM Agreement* itself, there is no export subsidy provided to processors in commercial export transactions. In particular, there is no export subsidy within the meaning of paragraph (d) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, contrary to the complainants' arguments under that Agreement.

4.74 Canada noted that three conditions must be met in order for a measure to constitute an export subsidy under paragraph (d) of the Illustrative List. The first of these conditions (i.e. that governments must provide goods either directly or indirectly through government mandated schemes) is clearly not met. Since every export subsidy in the Illustrative List is by definition an Article 1.1 "subsidy" that is contingent on export performance, the words "indirectly through a government mandated scheme" must have a meaning consistent with Article 1.1(a)(1)(iv). To hold otherwise would render the words "i.e. where" in paragraph 1.1(a)(1) completely meaningless and would amount to grafting a new type of "financial contribution" onto the definition of "subsidy" in the *SCM Agreement*. Accordingly, for the same reason discussed previously regarding governmental action under Article 9.1(c) of the *Agreement on Agriculture*, governments do not provide milk to processors, either directly or indirectly through a government mandated scheme.

4.75 Given that the first requirement in paragraph (d) is not met, Canada continued, the other two conditions under paragraph (d) are irrelevant. In any event, processors can and do source milk for use in the manufacture of exported dairy products under the Import for Re-Export Program. IREP serves as a competitive alternative source to commercial export milk. At the time the original panel report was issued, there were no guidelines in respect of the Import for Re-Export Program to structure the discretionary authority associated with the Program. Canada has recently issued a set of guidelines.[67] Although, technically, the issuance of IREP permits is still discretionary, what is important is how that discretion is actually exercised. In practice, IREP requests that meet the guidelines are granted automatically. Indeed, every single one of the over 500 requests since 1 August 2000 to import milk or milk products for re-export has been granted. Moreover, once an IREP request is approved, import permits for individual transactions are electronically issued online. IREP users are free to import any quantity of milk or milk products they wish and to decide the export use to which the imported product will be put. Thus, in reality, access by Canadian processors through IREP to milk and milk products is unrestricted and depends on commercial considerations only.

4.76 In addition, Canada noted, it has been repeatedly held by the Appellate Body that, absent evidence that discretionary legislation is being applied in a manner contrary to WTO obligations,

[67] See Notice to Importers, Export and Import Permits Act, Serial no 616, 17 April 2001 (Exhibit CDA-33).

there can be no presumption of inconsistency: "Only legislation that mandates a violation of GATT obligations can be found, as such, to be inconsistent with those obligations."[68]

4.77 In answer to a question by the Panel, Canada indicated that the average weighted price for fluid milk during the period August 2000-February 2001 was $0.44 per kilogram. However, Canada considered that this average price is significantly inflated by imports under the programme of pasteurised milk for ships' stores use. Canada noted that imported raw milk is bought at prices reflective of US market conditions for such milk. As concerns the average price of imported whole milk powder during this period, on a per hectolitre equivalent basis, it was $20.46.[69] Canada was of the view that whole milk powder is competitive with raw milk in industrial processing. The differences between the two products relate mainly to issues of transportation and storage. Indeed, in many cases the re-hydration of whole milk powder for a number of end uses is more cost effective than paying the transportation and storage costs associated with the use of raw milk. Imports of whole milk powder have almost tripled since the previous Panel proceedings and now account for approximately half of total imports under the programme.

4.78 In **New Zealand's** opinion, Canada's response to the question by the Panel concerning the IREP does not change the essential nature of the IREP scheme. The programme remains discretionary in nature and the "guidelines" appear to be nothing more than a listing of the substantial number of requirements that need to be met. In addition, it appears from information provided by Canada [70]that the "within access commitment" tariff continues to apply to IREP as it did in earlier years. A tariff is itself a form of restriction and thus, in New Zealand's view, imports under the IREP do not depend only on commercial considerations. Moreover, a "permit fee" is also applicable for each permit under the scheme, fees which are not applied to commercial transactions.

4.79 Referring to Canada's answer to a question by the Panel with respect to the IREP (see paragraph 4.75 above), the **United States** contended that it is irrelevant whether or not all requests for permits have actually been granted, for the purposes of the issues before this Panel. The question with regard to IREP is whether fluid milk is available on terms that are as favourable as those available for commercial export milk. The United States was of the view that the terms are not as favourable since a permit which is subject to the government's discretion must be obtained. This is not changed by the new guidelines. These do not change or circumscribe the Minister's discretion. Indeed, in paragraph 4.3 of the guidelines, it states simply that "the Minister *may* issue to any resident of Canada applying therefore a permit …"[71] In other words, although the government has granted the last 500 requests, it is within the Minister's discretion to deny the next 500 requests. As concerns Canada's answer to another question by the Panel (see paragraph 4.77 above), the United States responded that the price of imported fluid milk under the IREP is too high to be as favourable as milk obtained trough domestic sources for export contracts. Secondly, in the opinion of the United States the price of whole milk powder and that of fluid milk are not equally favourable since the whole milk powder price is almost double that of fluid milk according to US calculations when certain corrections have been applied to Canada's calculations. Third, even if whole milk powder were available at the same price as fluid milk, it would still be available on less favourable terms since it would need to be re-hydrated for most end-uses, implying additional time and expense in spite of technological advances.

4.80 **Canada** indicated that every one of the over 500 requests had been granted since 1 August 2000. Thus, the mere presence of discretion does not, in reality, render the choice between

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[68] *United States - Act of 1916* Appellate Body report, paragraph 60.
[69] @ 11 kg. per hectolitre.
[70] Notice to Importers, Export and Import Permits Act, Serial no 616, 17 April 2001 (Exhibit CDA-33).
[71] Notice to Importers, Export and Import Permits Act, Serial no 616, 17 April 2001 (Exhibit CDA-33).

domestic and imported products "restricted" or "not dependant only on commercial considerations". Canada also submitted that the United States incorrectly revised Canada's calculation of the milk-equivalent average price of whole milk powder imported under the IREP. Using appropriate conversion factors, milk-equivalent prices remain within the range of commercial export milk prices even if one were to use the average value of imported whole milk powder cited by the United States.

4.81 The **United States** submitted that Canada's argument with respect to Article 10.1 is without legal support and should be rejected by the Panel. Canada's argument that there must be a "direct connection" is not supported by the language of Article 10.1 of the Agriculture Agreement or paragraph (d) of the Illustrative List of Export Subsidies contained in Annex 1 to the *SCM Agreement.* The United States reiterated that the original panel concluded that it was more appropriate to consider paragraph (d) of the Illustrative List than the general concepts of Article 1 of the *SCM Agreement* when analysing the context of Article 10.1 of the *Agreement on Agriculture*. The new provincial export programmes satisfy each of the elements of paragraph (d). Accordingly, the new export programmes constitute export subsidies for purposes of the *SCM Agreement.* Because the *SCM* Agreement is part of the context of the *Agreement on Agriculture*, the fact that the provincial programmes constitute a subsidy under the Illustrative List supports a finding that the programmes are export subsidies under Article 10.1 of the *Agreement on Agriculture*. Additionally, Canada does not dispute that there are no restraints on the availability of the export subsidies under the new export programmes. Consequently, the export programmes have already resulted in or threaten to lead to the circumvention of Canada's reduction commitment within the meaning of Article 10.1.

**5. Articles 3.3 and 8 of the Agreement on Agriculture**

4.82 **New Zealand** submitted that, any export of dairy products by Canada under Special Milk Class 5(d) and the new schemes in excess of its reduction commitment levels constitutes a violation of Canada's obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture.*

4.83 A review of available export data, the **United States** submitted, shows that, when the volume of exports made pursuant to Special Milk Class 5(d) is combined with exports made under the provincial marketing schemes, the total aggregate volume of exports of cheese already exceed Canada's reduction commitments and exports of other milk products are barely below the quantity of subsidised exports that may be permitted consistent with Canada's reduction commitments. Consequently, because the new provincial export schemes constitute export subsidies, Canada's exports of cheese and other dairy products breach its obligations under Articles 3.3, 8 and 9 of the *Agreement on Agriculture.*

4.84 **Canada** contended that since it has not exported in excess of its reduction commitment levels, there was no violation of Articles 3.3 and 8 of the *Agreement on Agriculture.*

**6. Articles 1 and 3 of the SCM Agreement**

4.85 The **United States** submitted that, in addition to constituting violations of Articles 9.1(c), or in the alternative, Article 10 of the *Agreement on Agriculture*, Canada's measures affecting the exportation of dairy products constitute prohibited export subsidies pursuant to Articles 1.1 and 3.1 of the *SCM Agreement.* These measures --i.e. Canada's new provincial export subsidy programmes as well as the maintenance of Special Class 5(d) -- provide discounted milk to milk dealers on the condition that the milk is exported to foreign markets. They do so by allowing exporters to purchase milk at prices that are below prevailing market-levels as compared to milk used in dairy products sold in Canada's domestic market. Access to this low-priced product is contingent on the product being exported, because should a milk dealer divert the low-priced milk or products made from it to the domestic market, the milk dealer must pay a severe penalty. The result is that milk sold for export is

often half the price of milk sold on the domestic market. Therefore, Canada's measures constitute subsidies contingent upon export performance in violation of Article 3.1(a) of the *SCM Agreement.*

4.86 In demonstrating a violation of Article 3 of the *SCM Agreement*, the United States submitted that it relied upon paragraph (d) of the Illustrative List of Export Subsidies in Annex 1 to the SCM Agreement. Canada criticised this approach as inappropriately abbreviated. However, Canada adopted and indeed championed the same approach in another subsidies case. In *Brazil - Aircraft*, Canada argued that a measure that satisfies the requirements of the Illustrative List is *ispo facto* an export subsidy and therefore prohibited.[72] Just as in *Brazil - Aircraft*, the Panel in this dispute is confronted with a *per se* violation of Article 3 of the *SCM Agreement.*

4.87 The United States therefore claimed that Canada's measures constitute subsidies contingent upon export performance in violation of Article 3.1(a) of the *SCM Agreement*, and the appropriate remedy shall be withdrawal of the subsidy without delay pursuant to Article 4.7 of the *SCM Agreement.*

4.88 **Canada** responded that since there is no "subsidy" conferred to processors within the meaning of Article 1.1(a)(1)(iii) or (iv), there can be no "prohibited export subsidy" under Article 3 of the *SCM Agreement.* The arguments of the United States under this provision should, therefore, also be rejected.

[72] *Brazil - Aircraft*, panel report, paragraph 4.48.

# V. THIRD PARTIES ARGUMENTS

## A. AUSTRALIA

### 1. General

5.1 Australia considered that creating a separate regime for milk used in the export of dairy products ensures that processors/exporters have access to inexpensive milk. Whether labelled as special milk class 5(e) or excluded from quota milk for domestic consumption, the effect is the same. The replacement measures continue to provide milk at a price below an adequate level of remuneration, are contingent on the export of the manufactured product, and therefore would constitute an export subsidy under both the *Agreement on Agriculture* and the *SCM Agreement.* Milk for export is excluded from the domestic market; the only way that producers can sell above-quota or non-quota milk is if it is exported. And the only way that processors can receive lower price discounted milk is if it is for export. Without the prohibition on selling milk for export in the domestic market, processors for export would not have access to milk at discounted prices.

5.2 The fact that milk is "pre-committed" and "first-out-of-the-tank"[73] ensures that processors receive discounted milk. This does not alter the fact that a producer would not produce commercially for export (that is non-quota milk) where the returns are so low compared to milk for domestic consumption while the domestic milk supply management system is maintained and a producer can secure high prices for milk for domestic consumption. In the view of Australia, export milk is surplus to Canada's domestic supply management needs.

### 2. Article 9.1 (c) of the Agreement on Agriculture

5.3 Australia noted that there are two requirements under Article 9.1(c): (i) "payments on the export of an agricultural product"; and (ii) the payments must be "financed by virtue of governmental action".

*(i) "payments"*

5.4 Australia referred to the Appellate Body report which upheld the original panel's finding in relation to the meaning and definition of "payment" in the context of Article 9.1 (c).[74] The Appellate Body found that the word "payments" "denotes a transfer of economic resources"; further, "a 'payment' could be made in a form, other than money, that confers value, such as by way of goods or services."[75] The provision of milk at discounted prices to processors for export constitutes "payments" in a form other than money within the meaning of Article 9.1(c) of the *Agreement on Agriculture.* As the milk is supplied at below market rates, "'payments' are, in effect, made to the recipient of the portion of the price that is not charged".[76]

5.5 Just as under the Special Milk Classes system, Australia continued, the replacement measures provide a benefit to processors/exporters since the processors/exporters receive milk at a price that enables them to export the processed product concerned. Despite export milk being "excluded" from the domestic market, it is only non-quota milk that is available to processors for export. Milk for export cannot be redirected to the domestic market.

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[73] Documents describing provincial dairy export mechanisms, dated 22 September from Canada's Department of Foreign Affairs and International Trade.

[74] *Canada - Dairy*, Appellate Body report, paragraphs 107, 112-113.

[75] *Id.*, paragraph 107.

[76] *Id.*, paragraph 113.

5.6 Processors receive milk for export at below the price for milk destined for domestic consumption. The very fact, Australia argued, that Canada has deemed by legislation that there are "separate" markets provides a benefit or advantage to processors not otherwise available in the (domestic) marketplace.[77] Milk for export could not be obtainable at such a low price to processors without the existence of domestic price support. The Canadian supply management system/regulatory scheme is underpinned and implemented by Federal and provincial legislation and regulations and milk marketing boards.

*(ii) "financed by virtue of governmental action"*

5.7 Australia noted that in examining the second element of Article 9.1(c), namely whether payments are "financed by virtue of governmental action", the Appellate Body observed that "it is appropriate to look to the "governmental" involvement as a whole and not just to the role of the provincial milk marketing boards"[78]. The Appellate Body further noted that "the price paid for the milk by the *processors* is not, in any way, dependent on whether milk is part of in-quota or over-quota production".[79]

5.8 The domestic milk supply management system is managed, monitored and supervised by agencies of the Canadian federal or provincial governments, Australia continued. The volume and pricing of milk is still determined by these agencies. Regulatory schemes are enacted at both the federal and provincial levels. The provincial governments and the CDC still control the "separate" domestic and export markets. They determine the size of the quota for the domestic market. Export milk is still licensed by provincial milk marketing boards[80] and producer levies are still required to be paid regardless of the destination of the milk.[81] All the control in relation to the pooling, pricing, volume of milk etc continues to be regulated through the CDC and the provincial milk marketing boards. Australia considers that the replacement measures which create a 'separate' export milk regime continue to provide "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* by virtue of governmental action.

5.9 In summary, Australia considered that the replacement measures continue to provide "payments" on the export of dairy products within the meaning of Article 9.1(c) of the *Agreement on Agriculture* by virtue of governmental action. Accordingly, Canada should bring its replacement measures for dairy products into conformity with its WTO obligations.

**3. Article 3 and 8 of the Agreement on Agriculture**

5.10 Since the replacement measures are export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* and to the extent that Canada's dairy exports exceed Canada's annual quantity commitments, Australia considered that Canada is in breach of Article 3.3 of the *Agreement on Agriculture* not to provide export subsidies in excess of its budgetary outlay and quantity commitments levels specified in Section II of Part IV of its Schedule and in breach of Article 8 of the *Agreement on Agriculture* not to provide export subsidies otherwise than in conformity with the Agreement and with the commitments specified in its schedule.

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[77] Submission by Canada, paragraphs 83 ff.
[78] *Canada - Dairy*, Appellate Body report, paragraph 119.
[79] *Id*., paragraph 121.
[80] Dairy Farmers of Ontario Milk General Regulation 09/00, Section 5.
[81] *Id*., Section 7.

### 4. Article 10.1 of the Agreement on Agriculture

5.11 In the alternative, Australia argued, if the replacement measures are not found to be a 9.1(c) export subsidy under the *Agreement on Agriculture*, the measures would still amount to an export subsidy, as defined under Article 1(e) of the *Agreement on Agriculture*, [82] as captured by Article 10.1 of the *Agreement on Agriculture*. The object and purpose of that Article is to prevent the circumvention of export subsidy commitments. As there is no limitation or restraint on Canada's export subsidies on dairy products, Canada's replacement measures threaten to lead to circumvention of its export subsidy commitments. This is reinforced by Article 10.3 which places the onus on an exporting Member to demonstrate that any exports in excess of its scheduled commitments are not subject to export subsidies. As noted above, in Australia's view, the replacement measures provide an export subsidy and so the onus is on Canada to demonstrate that it is not in breach of its export subsidy commitments.

### 5. Article 3 of the SCM Agreement

5.12 Australia argued that the replacement measures in question fall under Article 3.1(a) of the *SCM Agreement*. Since Canada is in breach of its export subsidy commitments under the *Agreement on Agriculture*, it does not receive cover through Article 13(c) of the *Agreement on Agriculture*, and so is in breach of Article 3 of the SCM. In the alternative, if the Panel finds that the replacement measures are not an export subsidy within the meaning of the *Agreement on Agriculture* but are an export subsidy under Article 3.1(a) of the SCM, then again Canada would receive no cover from Article 13(c) of the *Agreement on Agriculture*, and so would be in breach of Article 3 of the *SCM Agreement*.

5.13 Australia noted that Canada claims that export milk is not "surplus" to domestic requirements but is pre-planned and pre-committed production. However, Canada does not address the fact that the ability of a producer to acquire additional quota (essentially through trading of quota) is determined by a system of legislation and regulations which set the quota volumes. The fact that the quota volumes are being adjusted more frequently by government suggests greater manipulation of product available for the export market.

5.14 As concerns the benchmark price advocated by Canada, Australia considered that the point of comparison is the domestic or regulated market. This is the basis on which it is determined whether milk is supplied at or below market rates. By virtue of Canada's supply management system and consequent high domestic prices, the price of milk to processors is below market rates and therefore constitutes a payment. Further, through regulatory control of a "separate" export market, Canada has assured processors that they will not have to pay the domestic price by "preventing" export milk being diverted into the domestic market.

## B. EUROPEAN COMMUNITIES

### 1. Article 9.1 (c) of the Agreement on Agriculture

#### *(i) "financed by virtue of governmental action"*

5.15 The **EC** was of the view that the complainants' citation to the test developed by the Appellate Body for "by virtue of governmental action" is incomplete and therefore misleading. The United States and New Zealand only purport to show that governmental action is "indispensable to the

[82] ""[E]xport subsidies" refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement."

occurrence of the payment".[83] However, the Appellate Body differentiates in a more nuanced manner whether governmental action "is not simply involved", but whether it is "in fact, indispensable" for "the transfer of resources, to take place".[84]

5.16 Referring to the complainants' arguments concerning the segregation of the market for contracted export milk from the domestic market[85], the EC submitted that these arguments imply that all kinds of purely regulatory government measures could amount to export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* simply because, by affecting market conditions, they necessarily have an impact on the conduct of certain economic operators and "may" have incidentally a trade distorting effect.

5.17 The EC noted that Article 9.1(c) departs from the general notion of subsidy laid down in Article 1.1 of the *SCM Agreement* by not requiring that a payment must involve a charge on the public account. This wording does not prevent producer-financed payments on the export of an agricultural product to qualify as export subsidy. However, the condition is that such payments must be "financed by virtue of governmental action". The key question, therefore, is to determine the extent of governmental involvement in the transfer of economic resources between agricultural producers and export processors.

5.18 The EC, referring to Canada's arguments that there must be a direct connection between governmental action and payments and relying on the dictionary meaning of the term "by virtue of", submitted that that expression, when compared to the notion of "government-*mandated*" schemes in item (d) of the Illustrative List of export subsidies annexed to the *SCM Agreement*, does not establish a particular degree of government involvement. The EC considered rather that the term "financed" provides important guidance in that respect. To finance means, to "engage in or manage financial operations".[86] Moreover, the term "financed" implies that money is being paid, i.e., a financial contribution is being made. The immediate context of the expression "financed by virtue of governmental action" is also relevant to its interpretation. Article 9.1(c) illustrates its scope by laying down an example, i.e., "payments that are *financed* from the proceeds of a levy *imposed* on the agricultural product concerned". This suggests that the transfer of economic resources under Article 9.1(c) must (i) be imposed by the government, and (ii) involve a kind of zero sum situation, where the exporters win what the producers lose.

5.19 In the opinion of the EC, neither the example of a protective duty, as cited by the panel in its original report, nor a double-pricing system as such can fulfil the conditions set by Article 9.1(c), if producers can still freely determine whether to sell over-quota products at cost plus margin or not to produce them at all. Under such conditions, the decision of farmers is only an incidental effect of a general regulatory measure which may have trade distortive effects, but still does not fulfil all conditions to be a WTO incompatible export subsidy.

5.20 Such a strict reading of "financed by virtue of governmental action" is further buttressed by the purpose of Article 9.1 of the *Agreement on Agriculture* which, in the view of the EC, was intended

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[83] First Written Submission of New Zealand, paragraph 7.11; First Written Submission of the United States, paragraph 82.

[84] *Canada –Dairy,* Appellate Body report, paragraph 120.

[85] First Written Submission of the United States, paragraphs 79, 83, 86 and 90; Second Written Submission of the United States, paragraphs 9, 16 and 55; First Written Submission of New Zealand, paragraphs 7.12-7.16; Second Written Submission of New Zealand, paragraphs 1.03, 2.10, 3.01 and 4.13. See also Third Party Submission of Australia, paragraph 3 as well as the panel report in *Canada – Dairy*, as modified by the Appellate Body report, paragraph 7.62.

[86] Shorter Oxford Dictionary, Volume I, at 950.

to provide a "careful, specific list of the principal categories of export subsidies that were known to be provided to the agricultural sector at the time the *Agreement on Agriculture* was drafted."[87]

5.21 The EC therefore submitted that the major argument of the complainants regarding the exclusion of contracted export milk from the domestic market is not, in itself, sufficient to establish that payments were "financed by virtue of governmental action".

**2. Article 10.1 of the Agreement on Agriculture**

5.22 The EC took issue with the broad interpretation of the concept of "export subsidies not listed in paragraph 1 of Article 9", advocated by the complainants. In particular, New Zealand argues that "all measures that do not technically meet the strict letter of Article 9.1, but have the same economic effect", must fall within Article 10.1.[88] The United States asserts that any argument whereby the standard for finding a subsidy under Article 10 is the same as under Article 1 of the *SCM Agreement* is without legal support.[89]

5.23 Referring to the text of Article 1(e) of *Agreement on Agriculture,* the EC submitted that it leaves open the question of whether the definition of subsidy under the *Agreement on Agriculture* is the same as under the *SCM Agreement.* The Appellate Body has not yet clarified the precise notion of export subsidy applicable under Article 10.1 of *the Agreement on Agriculture*. In *United States – FSCs*, the Appellate Body developed a general definition of subsidy whereby "a 'subsidy' involves a transfer of economic resources from the grantor to the recipient for less than full consideration", but drew heavily on the general context of the *SCM Agreement.*[90] The Appellate Body also saw no reason to read the requirement of "contingent upon export performance" in the *Agreement on Agriculture* differently from the same requirement imposed by the *SCM Agreement,* because "the two agreements use precisely the same words to define export subsidies".[91]

5.24 Although not attempting to develop a comprehensive analytical framework of the precise relationship between the notion of export subsidy under Article 1(e) of the *Agreement on Agriculture* and Article 1.1 of the *SCM Agreement,* the EC put forward the following: the term "subsidy" is the same under both agreements, as is the expression "contingent upon export performance". Secondly, several provisions directly bear on the relationship between the concept of export subsidy under Article 1(e) and 10.1 of the *Agreement on Agriculture* and that under the *SCM Agreement.* Thus, Article 21 of the *Agreement on Agriculture* provides that "the provisions of the GATT 1994 and of other multilateral trade agreements shall apply subject to the provisions of this Agreement". Article 3.1 of the *SCM Agreement,* in turn, prohibits export subsidies "except as provided in the Agreement on Agriculture". This suggests a co-extensive application of the notion of subsidy, unless the *Agreement on Agriculture* explicitly provides otherwise, as, e.g., through the specific list of export subsidies in Article 9.1.

5.25 Another argument, the EC continued, can be gleaned from Article 13 of the *Agreement on Agriculture*, entitled "due restraint", which foresees that export subsidies which conform fully to the provisions of Part V of this Agreement shall be "subject to countervailing duties only upon determination of injury or threat thereof based on volume, effect on prices, or consequent impact in accordance with Article VI of the GATT 1994 and Part V of the Subsidies Agreement". This

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[87] Appellant's Submission of the United States in *United States - FSC*, paragraphs 321-322, agreed to by the EC in its Appellee's submission, paragraph 258.

[88] First Written Submission of New Zealand, paragraph 7.27. See also, Second Written Submission of New Zealand, paragraph 4.22.

[89] Second Written Submission of the United States, paragraphs 51, 52.

[90] *United States – FSC*, Appellate Body report, paragraph 136.

[91] *Id*., paragraph 141.

reference implies that a Member wishing to impose countervailing duties could determine the existence of a subsidy on the basis of Article 9.1 of the *Agreement on Agriculture* in addition to Articles 1-3 of the *SCM Agreement* and therefore requires a co-extensive application of the basic concept of subsidy. The EC did not see any provision in the *Agreement on Agriculture* that mandates the use of different concepts of subsidies. The chapeau of Article 1.1 of the *SCM Agreement*, which states that "[f]or the purpose of this Agreement, a subsidy shall be deemed to exist" does not exclude that other agreements refer back to this basic definition of subsidy which is the only one agreed on by the Members. Like the expression "contingent upon export performance", the term "subsidy" is the same under both agreements.

5.26 In conclusion, the EC failed to understand how one of those concepts can be subject to a diverging interpretation depending on whether it arises in the context of the *SCM Agreement* or the *Agreement on Agriculture*, while the other is consistently interpreted. Such an approach is certainly not justified on the basis of the language and context of Articles 1(e) and 10.1 of the *Agreement on Agriculture.* To the contrary, the EC considered that a pick and choose approach resulting in an oscillating notion of subsidy under the anti-circumvention provision does not provide security and predictability to trade in agricultural products.

# VI. FINDINGS

## A. *AGREEMENT ON AGRICULTURE*

### 1. Burden of Proof

6.1 New Zealand and the United States argue that pursuant to Article 10.3 of the *Agreement on Agriculture*, Canada must establish that no export subsidy has been granted in respect of exports exceeding Canada's reduction commitments. Canada "recognises the presence of Article 10.3", but submits that "it is important to note that reports issued by panels and the Appellate Body under Article 21.5 of the DSU uniformly confirm that a Member's measure is presumed to comply with WTO obligations and, thus, any Member challenging that measure bears the burden of proof."

6.2 Article 10.3 of the *Agreement on Agriculture* provides,

> Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question.

6.3 The Panel considers that, when reduction commitments have been exceeded, Article 10.3 has the effect of reversing the usual burden of proof with regard to claims made under Articles 3.3, 9 and 10 of the *Agreement on Agriculture*.[92] Thus, in the case before the Panel, if dairy exports exceed Canada's reduction commitments, and Canada claims that any quantity of exports exceeding its commitment levels is not subsidized, then it is for Canada to present evidence which is sufficient in terms of Article 10.3 to establish a presumption that no export subsidy has been granted in respect of the quantities exported in excess of its reduction commitment levels.

6.4 The Panel does not consider that the rules on the allocation of the burden of proof change simply because a claim is made in the context of Article 21.5 DSU proceedings. The Panel notes in that respect the following statement by the Appellate Body in its report in *Brazil - Aircraft (21.5)*:

> We recall that, before the original panel in *Brazil – Aircraft*, Brazil conceded that it had the burden of proof in demonstrating its alleged "defence" under item (k). However, in these Article 21.5 proceedings, Brazil argues that this burden of proof, under item (k), is on Canada. In our view, *the fact that the measure at issue was "taken to comply" with the "recommendations and rulings" of the DSB does not alter the allocation of the burden of proving* Brazil's "defence" under item (k). (emphasis added)

The Panel considers that this reasoning equally applies to the allocation of the burden of proof pursuant to Article 10.3 of the *Agreement on Agriculture.*

6.5 It is clear from the text of Article 10.3, however, that the burden of proof with regard to Articles 3.3, 9 and 10 is only reversed *if* reduction commitment levels have been exceeded. The exceeding of reduction commitment levels triggers the reversal of burden of proof pursuant to

[92] As acknowledged by Canada in the original panel proceedings. See report of the panel on *Canada – Dairy*, paragraph 7.33.

Article 10.3. The Panel must therefore turn to the question whether reduction commitment levels have indeed already been exceeded by Canadian dairy exports.[93]

6.6 The Panel notes in this respect that, according to Canada, total cheese exports from Canada between August 2000 and February 2001 amounted to 10,026 metric tons.[94] Canada's reduction commitment level for the marketing year 2000/2001 was set at 9,076 metric tons. The Panel thus finds that Canada's reduction commitment level for cheese has been exceeded. The Panel notes that Canada claims that a quantity of those excess exports is not being subsidized. The Panel, therefore, concludes that, with regard to the claims made under Articles 3.3, 9 and 10 of the *Agreement on Agriculture*, Canada has the burden of proof.

**2. Article 9.1(c)**

(a) Introduction

6.7 In deciding on the Article 9.1(c) claim, the Panel will address the following questions on the basis that a measure or arrangement which meets all of the substantive requirements of Article 9.1(c) constitutes an export subsidy for the purposes of the *Agreement on Agriculture*:

(a) Are there "payments"?

(b) If so, are such payments "financed by virtue of governmental action"?

(c) If so, are those payments made "on the export of an agricultural product"?

(b) "Payments"

6.8 New Zealand and the United States argue that the prices at which Canadian milk processors source commercial export milk ("CEM") are significantly below the prices at which Canadian milk processors source milk for the domestic market, and that Canadian milk producers are therefore foregoing revenue in the same manner that the Panel and the Appellate Body have found to constitute a payment. In their view, in determining whether a "payment" is made within Article 9.1(c), the Panel must assess what would have been otherwise available to processors/exporters in the marketplace.

6.9 Canada refers to paragraph 113 of the Appellate Body report in *Canada – Dairy*, the second sentence of which states that

> [i]f goods or services are supplied to an enterprise, or a group of enterprises, at reduced rates (that is at below market rates), "payments" are, in effect, made to the recipient of the portion of the price that is not charged.

According to Canada, the corollary of this proposition is that where the recipient of goods or services pays market rates or market value, there can be no "payment." Since the commercial export milk market has been deregulated, processors are paying "market value" for the milk. Therefore, in Canada's view, commercial export milk in Canada is being sold at, not below, market rates, and, in line with the aforementioned Appellate Body citation, there could be no "payment."

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[93] The Panel considers that the ordinary rules on burden of proof apply to a claim that reduction commitment levels have been exceeded, and, accordingly, that it is in the first instance up to the complainants to establish a *prima facie* case that exports of the product are in excess of the commitment level relating to that product.

[94] Canada's reply to Question 22.

6.10 Before assessing the parties' arguments, the Panel notes that there appears to be no disagreement between the parties as to whether the prices paid for domestic market milk and those paid for what is described as commercial export milk show a clear differential. On the one hand, New Zealand provides data indicating that current commercial export milk prices per hectolitre are within the range of C$25.03 to C$35.09. The United States provides an average value of C$31.53 per hectolitre for Ontario and C$29 per hectolitre for Quebec. Canada states that prices range from C$19.06 to C$36.86 per hectolitre of commercial export milk. According to New Zealand and the United States, domestic market milk, on the other hand, sells for anywhere between C$49.48 and C$56.06 per hectolitre (New Zealand), or, at an average, for C$52.92 per hectolitre (the United Stataes). Canada has not disputed the latter figures.

6.11 The parties, however, clearly differ over what the Appellate Body meant by the supply of goods "at below market rates". According to New Zealand and the United States, the market rate is the higher price of milk in the regulated domestic market. According to Canada, the lower CEM price resulting from "arm's length transactions in a private commercial context"[95] is the market rate. Consequently, in order to decide whether a "payment", within the meaning of Article 9.1(c), is made to processors for export through the provision of commercial export milk at lower prices than domestic milk, the Panel needs to determine against what *benchmark* the commercial export milk prices have to be compared.

6.12 The Panel first recalls that the ordinary meaning of "payment" has already been examined by both the Panel and the Appellate Body in the original proceedings. The Appellate Body considered that the word "payments" in Article 9.1(c) denotes a transfer of economic resources,[96] and agreed with the panel that the ordinary meaning of the word "payments" in Article 9.1(c) encompasses "payments" made in forms other than money, including revenue foregone.[97] The Appellate Body concluded that,

> In our view, the provision of milk at discounted prices to processors for export under Special Classes 5(d) and 5(e) constitutes "payments", in a form other than money, within the meaning of Article 9.1(c). If goods or services are supplied to an enterprise, or a group of enterprises, at reduced rates (that is, at below market-rates), "payments" are, in effect, made to the recipient of the portion of the price that is not charged. Instead of receiving a monetary payment equal to the revenue foregone, the recipient is paid in the form of goods or services. But, as far as the recipient is concerned, the economic value of the transfer is precisely the same.[98]

6.13 The Panel notes that the ordinary meaning of "payments" in Article 9.1(c), as determined by the Appellate Body, does not provide *explicit* guidance as regards the benchmark which is to be applied when determining whether goods are being provided at "discounted", "reduced" or "below market" rates. It is clear that, *in casu*, the regulated export price was considered "discounted", "reduced" or "at below market rates" as compared with the regulated price of milk destined for the domestic market. Canada argues, however, that when the export price is no longer regulated, the benchmark would change from the regulated domestic market price to the deregulated export market price. Canada bases this assertion, *inter alia*, on the Appellate Body's reference to "at below market rates", arguing that the "market rate" can only be the price resulting from "arm's length transactions in a private commercial context".

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[95] Canada's First Submission, paragraph 84.
[96] Report of the Appellate Body on *Canada - Dairy*, paragraph 107.
[97] *Id*., paragraph 112.
[98] *Id*., paragraph 113.

6.14 The Panel is not persuaded by Canada's argument. The Appellate Body did indeed equate "reduced rates" with "below market rates" in paragraph 113 of its report. However, it can not be inferred from that statement that the Appellate Body meant to exclude from the meaning of "market rates" prices which were not the result of "arm's length transactions in a private commercial context" but, rather, the result of a certain degree of governmental intervention. On the contrary, the opposite conclusion is borne out by the very facts of the case which provide the context of the Appellate Body's statement. In the original dispute the export milk price was considered "discounted" in reference to a price which was clearly not the result of "arm's length transactions in a private commercial context". The "market rate" in that case was a price regulated by the government. The Appellate Body statement itself cited by Canada clearly allows for the possibility that the "market rate" is a price regulated by the government, and not the result of "arm's length transactions in a private commercial context". The Appellate Body statement therefore does not prejudge the question before the Panel whether, for the purpose of Article 9.1(c), the appropriate benchmark is the domestic regulated price or, as claimed by Canada, the price resulting from "arm's length transactions in a private commercial context".

6.15 Canada asserts along the same lines that "[t]he fact that prices in the regulated market are higher than the prices in the commercial export market is irrelevant",[99] and explains in its oral statement the reasons underlying that assertion:

> To understand the Appellate Body's ruling [in *Canada – Dairy*], it is important to examine the market conditions that were prevailing in Canada at that time. The Panel determined that *there was only one market* for milk in Canada: a regulated market (other markets were considered not to be viable alternatives for sourcing milk for export in Canada).
>
> […]
>
> As a result of Canada's implementation of the recommendations and rulings of the DSB, governments no longer set the prices for milk for export. *The domestic regulated market and the commercial export market now respond to different conditions of competition*.[100] (emphasis added)

Thus, according to Canada, there would now be two distinct milk markets, domestic and export, and, consequently, the domestic price benchmark to determine whether export prices are discounted can no longer be relevant. Canada notes that by deregulating the export milk market, it "has not created this market," but, rather, has "given producers and processors access to an existing market."[101]

6.16 The Panel is not convinced by Canada's argument. The Panel does not agree with the market definition which Canada proposes in order to determine whether a "payment" exists within the meaning of Article 9.1(c). Pursuant to Canada's argument, for the purposes of Article 9.1(c), a "transfer of economic resources" from the grantor to the recipient can not take place in a given market if there is a different degree of government intervention in that market, depending on whether a good is destined by the buyer for export or not. In this case, the Canadian government intervenes extensively with regard to dairy transactions when the milk is destined for the domestic market, and intervenes less extensively[102] with regard to dairy transactions when the milk is destined for export. The Panel notes, however, that the "commercial export market" is not any different from the

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[99] Canada's Rebuttal Submission, paragraph 13.
[100] Canada's Oral Statement, paragraphs 43-47.
[101] Canada's Oral Statement, paragraph 49.
[102] See, for instance, paragraphs 6.46-6.47 below.

domestic market in terms of sellers,[103] buyers[104] and the products[105] which they trade. The only difference between these "two" markets is Canada's degree of government intervention, depending on whether the buyer purchases milk for export or not. Thus, Canada makes a distinction between these domestic and export dairy markets on the sole basis of the degree of its own regulatory intervention in transactions between producers and processors. This distinction between markets, for the purposes of determining against what benchmark the existence of a "discount" needs to be assessed, solely according to the degree of regulatory intervention by government, is not warranted by either the text and context of Article 9.1(c), or the object and purpose of the *Agreement on Agriculture.*

6.17 First, with regard to the text, as noted earlier, nothing in the wording of Article 9.1(c) suggests that the degree of government intervention, in function of the destination of the processed product, should affect the interpretation of "payment". The question of government intervention is, of course, highly relevant under Article 9.1(c), but only in the analysis of the "financed by virtue of government action" requirement.

6.18 Second, as regards context, other paragraphs of Article 9.1 indicate that the proper comparison to be made in order to assess the existence of a "payment" is between the price charged for the domestic market and the price charged for export. According to Article 9.1(b), for instance, the sale for export by governments of agricultural goods *at a price lower than the comparable price charged for the like product to buyers in the domestic market* constitutes an export subsidy. Similarly, under Article 9.1(e), the provision by government of transport services for export shipments at *prices lower than the price charged for domestic shipments* is also an export subsidy. Nothing in the text of these paragraphs specifies to what extent the higher domestic price may result from government intervention. The only benchmark which is stipulated is the price for the domestic market, *independently of* the extent of government intervention in the formation of that price.

6.19 Third, Article 9.1(c), and the associated reference by the Appellate Body to the "market", should be read having regard to the object and purpose of the *Agreement on Agriculture*. The Panel considers that the Preamble of the *Agreement on Agriculture* provides useful guidance to identify the object and purpose of that Agreement. According to the Preamble, Members

> […] decided to establish a basis for initiating a process of reform of trade in agriculture […],

and recalled that

> their long-term objective […] "is to establish a fair and market-oriented agricultural trading system and that a reform process should be initiated through the negotiation of commitments on support and protection and through the establishment of strengthened and more operationally effective GATT rules and disciplines",

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[103] This conclusion is not affected by the fact that there are currently 74 producers in Canada who do not hold quota and produce milk exclusively for export. This group accounted for 0,08 per cent of total Canadian milk production between August 2000 and February 2001 (Canada's reply to Question 21), and constitutes less than 0,5 per cent of Canadian dairy producers (Canada's reply to Question 3).

[104] The Panel understands that Canadian milk processors can engage in marketing activities both on the domestic and export markets.

[105] Canada confirms that "[a]ll milk in a producer's bulk tank is collected. The quantity of commercial export milk is specified in the contract between the producer and the processor. Producers and processors identify commercial export milk deliveries through the commercial export milk contracts and processors' monthly plant utilization reports. As milk is fungible, commercial export milk is not stored or processed separately from other milk." (Canada's reply to Question 14)

and that

> […] "the above-mentioned long-term objective is to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period, resulting in correcting and preventing restrictions in world agricultural markets.

6.20 This language makes clear that the working assumption in agricultural trade is not that of a market free of government intervention. The establishment of a fair and market-oriented agricultural trading system, through progressive reductions in agricultural support and protection, is the long-term objective, and the *Agreement on Agriculture* has established a "basis for initiating the process of reform" aimed at achieving that long-term objective. In the meantime, markets subject to a certain degree of government regulation would appear to be rather the rule in agricultural trade, and regulation-free markets the exception. Claiming that, under Article 9.1(c), the right benchmark to determine whether a "payment" exists is the extent to which government has decided to intervene in the market, depending on whether a good is destined by the buyer for export or not, ignores that fundamental economic reality, as reflected in the object and purpose of the *Agreement on Agriculture*.

6.21 Finally, even assuming, for the sake of argument, that the Panel would agree with Canada that the "reduced" or "market" price is the price of those transactions in which government intervention is absent, Canada's argument would be self-defeating. The fundamental reason for this is that the commercial export milk price itself is, in reality, not a mere product of "arm's length transactions in a private commercial context".[106] At least part of that context is clearly government-regulated. At this stage, the Panel does not need to look further than Canada's oral statement that it has "given producers and processors access to" another market. Thus, by its own admission, the Canadian government has *intervened* for producers and processors to "have access to" that market. Thus, the very existence of – or, as Canada puts it – "access to" that market is premised on some degree of government intervention. As a result, should the Panel consistently apply Canada's argument, the benchmark for the comparison with the export price would not be that same export price, but the price which a processor would pay to a milk producer *but for any intervention by the Canadian government relating to supply and price management in the dairy market.* If the Canadian government were not to maintain a quota-system on the domestic market, and, hence, if the Canadian producers were able to produce more for the domestic market than they can now, supply for the domestic market would increase. The resulting market equilibrium milk price is likely to be lower than current domestic market prices, but higher than current export prices. In conclusion, even under Canada's "deregulated market" analysis, there would still be a difference, albeit less extensive, between current export prices and the counterfactual benchmark which would result from a consistent application of its argument.

6.22 Canada alludes to the "concession" by New Zealand that the current commercial export milk prices reflect "world prices", apparently suggesting that when the "market price" would be taken to mean the "world price", there would still be no "payment".[107] The Panel disagrees with Canada in two respects. First, for the reasons set out above,[108] the Panel considers that the domestic market price constitutes the right benchmark for the purpose of determining the existence of a payment under Article 9.1(c). Second, even assuming, for the sake of argument, that the Panel were to accept that world prices constitute the right benchmark, Canada's argument would fail.

6.23 The Panel notes that the panel in the original proceedings addressed the same issue when determining the existence of a payment in kind under Article 9.1(a):

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[106] Canada's Oral Statement, paragraph 49.
[107] Canada's Oral Statement, paragraphs 21 and 51.
[108] See paragraphs 6.12-6.21 above.

> We noted above that a benefit must be conferred for a payment in kind to exist in the sense of Article 9.1(a).[109] In this case, the question thus arises whether the provision of milk to processors/exporters under Classes 5(d) or (e) confers a benefit to these processors/exporters. This, in turn, raises the question of what the appropriate *benchmark* is for determining whether the provision of a good at a certain price confers a benefit.[110] Does it suffice, as the complainants argue, that milk for export use is provided to processors at a price below the *domestic milk price* for there to be a benefit conferred to these processors (hereafter referred to as "the first benchmark", namely the domestic milk price)? Or, does one need to establish that processors/exporters receive milk under Classes 5(d) and (e) at a price which is not only lower than the domestic milk price, but also lower than the price of milk these processors/exporters can obtain from any other source, in particular the price of milk they can source from the *world market* (hereafter referred to as "the second benchmark", namely the lowest milk price to be obtained from any other source)?[111] (emphasis added)

6.24 Without making a finding on the issue of the appropriate benchmark, the original panel proceeded, in the first instance, on the assumption that the second benchmark, although more favourable to Canada, was appropriate in the circumstances. In the panel's view, if the price of milk under Classes 5(d) and (e) was lower than the price at which processors/exporters could obtain milk from any other source, a bounty or benefit – i.e., something they would otherwise not have obtained – would, indeed, be conferred.[112] Canada had argued that milk imported under its Import for Re-Export Program ("IREP") would be available under equally favourable terms and conditions as those offered under Classes 5(d) and (e). The panel, however, concluded that the fact that the Minister had to issue a permit before such imports were allowed and that the Minister disposed of a wide discretion in doing so, was proof that these imports were not effectively available under equally favourable terms and conditions as those offered under Classes 5(d) and (e).[113]

6.25 This Panel notes that nothing has basically changed under Canada's IREP as regards the terms and conditions on which milk can be imported for export processing in Canada. Data has been provided which indicates that during the period August 2000 to February 2001 imports of dairy products under the IREP increased. However, Canada has confirmed that the Minister still has to issue a permit before such imports are allowed. In the light of the evidence before it as a whole, it appears to the Panel that the Minister still disposes of wide and untrammelled discretion as regards the issue of import licences under the IREP.[114] In addition, processors who wish to import under the IREP

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[109] [footnote omitted]
[110] [footnote omitted]
[111] Report of the panel on *Canada – Dairy*, paragraph 7.47.
[112] *Id*., paragraph 7.48.
[113] *Id*., paragraph 7.53.
[114] Canada's reply to Question 18. Although Canada asserts that licences are now granted automatically, the new Guidelines, dated 17 April 2001 and contained in Canada's Exhibit 33, merely confirm that

> "the Minister […] *may* determine an import access quantity which *may* be allowed to enter at the low rate of duty and the Minister *may* allocate it to residents of Canada." (Section 4.2)(emphasis added),

and that

> "the Minister *may* issue to any resident of Canada applying therefor a permit to import goods included in an Import Control List, in such quantity and of such quality, by such persons, from such places or

still have to pay an administrative permit fee.[115] Therefore, *even if* (i) world prices were to constitute the right benchmark for the purpose of determining the existence of a "payment" under Article 9.1(c), and *even if* (ii) current commercial export milk prices were to reflect world prices, the fact that the Minister has to issue a permit before IREP imports are allowed, that the Minister disposes of a wide discretion in doing so, and that payment of an administrative fee is required, is proof that these imports are not effectively available under equally favourable terms and conditions as those offered for commercial export milk.[116]

6.26 The Panel notes that the parties have also presented arguments regarding the competitive relationship between fluid milk and whole milk powder imported under the IREP, and that they have submitted conflicting evidence regarding milk equivalent prices of whole milk powder.[117] The Panel takes note of the parties' arguments on the matter, but considers that the fact that imports of IREP milk are subject to the discretionary licensing authority held by the Minister is sufficient for the Panel to conclude that IREP milk is not available on equally favourable terms.

6.27 For the reasons set out above,[118] the Panel accordingly finds that the provision of milk at discounted prices to processors for export under the CEM scheme constitutes "payments", in a form other than money, within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

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persons and *subject to such other terms and conditions as are described in the permit or in the regulations*." (Section 4.3)(emphasis added)

Thus, the new Guidelines do not appear to restrict in any way the Minister's discretion, and even if the Minister were to be exercising that discretion in a certain way today, under the new Guidelines he would be free to exercise it differently tomorrow. Canada's assertion that "absent evidence that discretionary legislation is being applied in a manner contrary to WTO obligations, there can be no presumption of inconsistency" (Canada's reply to Question 18, paragraph 35) is in the Panel's view irrelevant. The Panel is not assessing the WTO consistency of the IREP, but is simply determining whether or not milk can be sourced at equally favourable conditions through the IREP.

[115] Canada's Exhibit 33, Section 7.1.

[116] The Panel also considers that using world market price related benchmarks under Article 9.1 (which for many if not most agricultural products would in practice be difficult to establish) would tend to eviscerate the substance of the export commitments and defeat one of the main objects and purposes of the *Agreement on Agriculture*. Clearly, to do so would open up the possibility of using benchmarks under administratively created and controlled import for re-export schemes to get around the scheduled export subsidy reduction commitment levels under which only 25 WTO Members are able at present to use export subsidies.

[117] In its reply to Question 10 from the Panel, Canada has stated that the average weighted price for fluid milk for the period examined was C$0.44/kg. According to the United States, this price would approximately be C$45/hl and would therefore not be equally favourable as the CEM price. In addition, Canada has argued that whole milk powder is competitive with fluid milk and is available on equally favourable terms. According to the United States, however, imports of whole milk powder under the IREP do not constitute a source of milk that is available on equally favourable terms as domestically purchased milk. The United States has asserted, first, that, when appropriate corrections are applied, the C$20.46/hl price provided by Canada would be nearly doubled. Second, even if the price of whole milk powder were equally favourable, the United States disagrees that whole milk powder would be directly competitive with fluid milk. Canada has responded to the United States' comment stating that if one were to use other conversion factors used by the United States, as well as the average value of C$2.55/kg for imported whole milk powder, the resulting milk equivalent prices would remain within the range of CEM prices of C$29-$33/hl. Canada has also noted that there is no "standard conversion factor" between whole milk powder and raw milk, whether it be at the Canadian, US or international level. According to Canada, while there has been limited debate within the International Dairy Federation on milk equivalents, there is neither specific agreement nor general consensus on this issue.

[118] Paragraphs 6.11-6.26 above.

6.28 Having found the existence of a "payment", the Panel notes that this finding is fully consistent with the original panel's consideration in paragraph 7.62 of its report on *Canada - Dairy*, on which Canada has relied.[119] Paragraph 7.62 of the panel report reads:

> We want to stress, however, that the existence of this "payment in kind" to processors does not in and of itself establish the existence of an export subsidy within the meaning of Article 9.1(a). In our view, in particular the existence of parallel markets for domestic use and for export with different prices does not necessarily constitute an export subsidy.[120] *Whether or not the "payments-in-kind" to processors in this dispute constitute an export subsidy depends on the government's involvement in providing it.*[121] *This relates to the second condition under Article 9.1(a).* (emphasis added)

6.29 The Panel notes that this statement was made in the context of Article 9.1(a), not Article 9.1(c). Nevertheless, the Panel agrees with Canada that the statement merits reflection also in the context of Article 9.1(c). The Panel considers that, in the case before it, the mere "payment" would not in and of itself establish the existence of an export subsidy within the meaning of Article 9.1(c). In particular, the existence of parallel markets for domestic use and for export with different prices would not necessarily constitute such an export subsidy. This view, however, does not in any way conflict with the Panel's finding regarding the existence of a "payment".

6.30 First, the Panel draws attention to the last phrase of paragraph 7.62, which makes clear that the panel simply meant to say that a certain degree of government involvement is required for the "payment in kind" to become an export subsidy under Article 9.1(a): it must also be demonstrated that the payment in kind is "provided by governments or their agencies". The same reasoning holds true for Article 9.1(c): the existence of a "payment" is not sufficient to conclude that there is an export subsidy. The Panel must, in addition, examine whether that payment was "financed by virtue of government action".

6.31 Second, footnote 412 to paragraph 7.62 explains when the existence of parallel markets for domestic use and for export with different prices would *not* constitute an export subsidy:

> The price differential may, for example, be a consequence of high – but WTO consistent - import tariffs that can cause domestic prices to be higher than the world market price. In such scenario, efficient producers may take the decision – based on their own profitability - to also produce and sell milk for export, albeit at a lower price than the domestic price. If the decision to sell in either the domestic market or the export market is one made by the individual producer and *based on commercial grounds only* (e.g., on an allocation of sales to the two markets with a view to obtaining a maximized total revenue, taking into account the inherently limited domestic demand for milk and the lower price for export) - *not a decision by the government or its agencies taken on behalf of the producers* - such scenario would, in our view, not appear to be an export subsidy in the sense of Article 9.1. (emphasis added)

It is readily apparent, in the Panel's view, that the facts of this case do not fit with this hypothetical scenario. Domestic prices are high, not simply because of high import tariffs, but as a result of government regulation setting, *inter alia*, price floors and marketing quotas. At the same time, it confirms that only when the decision by Canadian producers to sell for either market is based

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[119] Canada's First Submission, paragraph 99.
[120] [footnote omitted]
[121] [footnote omitted]

exclusively on commercial considerations, the existence of parallel markets with different prices would not necessarily constitute an export subsidy. This is precisely the analysis to which the Panel will now turn.

(c) "Financed by Virtue of Governmental Action"

*(i) Arguments by the parties*

6.32 Both New Zealand and the United States argue that the above payments are being financed by virtue of governmental action, in reference to paragraph 120 of the Appellate Body report on *Canada – Dairy*, according to which this condition is met if governmental action is "indispensable" to the transfer of resources. Both claimants argue that, in this case, lower priced milk would indeed not be available to processors for export, and resources not transferred, *but for* the combined effect of a set of governmental measures.

6.33 Canada argues that there must be "a direct connection" between the governmental action and the payments, an interpretation which it sees confirmed by an ordinary meaning analysis of "by virtue of". According to Canada, such a direct connection does not exist in this case.

6.34 New Zealand and the United States argue, and Canada contests, that the following governmental measures, "taken as a whole", meet the standard of "financed by virtue of governmental action" under Article 9.1(c):

(a) The regulatory distinction between the domestic milk market and the commercial export milk market, whereby the former is regulated with respect to both quantity ceilings and price floors and the latter is exempt from such regulation.

(b) The prohibition against selling over-quota or non-quota milk into the domestic market, with the exception of class 4(m) milk (animal feed).

(c) The prohibition, both on federal and provincial level, against diverting any milk committed to export into the domestic consumption market, enforced by sanctions and penalties at the federal and provincial level.

(d) The regulations granting the authority to the Canadian Dairy Commission ("CDC") to audit the books and records of producers and processors to determine whether commercial export milk has been marketed for final consumption in Canada.

(e) The requirement that commercial export milk has to be "pre-committed" for export and "first out of the tank".

(f) As regards Ontario and Quebec, the obligation to sell all commercial export milk through an exclusive, mandatory bulletin board system where processors invite offers of milk for export contracts at prices established by the processors.

*(ii) Textual and contextual analysis of "financed by virtue of"*

6.35 The Panel notes that the dictionary meaning of "by virtue of" is "*by the power or efficacy of; now, on the strength of; in consequence of; because of*",[122] and "*by force of, by authority of, by reason*

[122] New Shorter Oxford English Dictionary (Lesley Brown, ed.), page 3586.

*of*".[123] The term appears to refer to (i) a certain degree of causality between cause and effect (in consequence of, because of, by reason of), and (ii) the exercise of a power to enforce obedience or influence action[124] (by authority of, by the power of). The Panel considers that dictionary meaning (i) is subsumed under dictionary meaning (ii): when a result is said to come about by the power to enforce obedience or influence action, the exercise of that power can be considered the cause, and the obedience or action the result. This is clear when the obedience is "enforced", but also when the action is simply "influenced": in both instances, the result would not occur *but for* the power to enforce or influence. The Panel considers that these dictionary meanings provide useful guidance regarding the ordinary meaning of "by virtue of".

6.36 The dictionary meaning of "to finance" is "*pay or put to ransom; engage in or manage financial operations; provide oneself with capital; provide with money, esp. capital; provide money for*".[125] The Panel considers that the ordinary meaning of "payments financed", as used in Article 9.1(c), is therefore "payments for which money is provided".[126]

6.37 The Panel now turns to an analysis of the context of "financed by virtue of" in Article 9.1. First, the Panel notes that Article 9,1(c) itself provides an example of what may be understood as meaning "financed by virtue of": when payments are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived, those payments would be "financed by virtue of" governmental action. In this example, the governmental action would supposedly be constituted by the *imposition* of the levy on the agricultural product concerned or on an agricultural product from which the exported product is derived. When government imposes such a levy, for example, it will also be government who *allocates* the proceeds of that levy to a certain beneficiary or group of beneficiaries in society. Therefore, when Article 9.1(c) states that payments are *financed from* the proceeds of the levy, it carries with it the implicit, but clear, understanding, that government has necessarily also *allocated* those proceeds to the financing of the payments. As a result, in the example provided by Article 9.1(c), "by virtue of" clearly implies the exercise of government power *with the effect of* financing payments on the export of agricultural goods, whereby the governmental action is *indispensable* for the funds to be transferred from grantor to recipient. The Panel, however, is aware that the example provided by Article 9.1(c) is merely illustrative, not exhaustive, and that, therefore, the scope of "financed by virtue of" is not necessarily restricted to the meaning imparted to it by this particular example.

6.38 Consideration should also be given to the context provided by the other paragraphs of Article 9.1. The Panel notes in this respect the prominent difference which exists as regards the nature and extent of government action required under paragraph (c) as compared with the other paragraphs of Article 9.1. Whereas paragraph (c) requires that the payment merely be "*financed by virtue of*" governmental action, other paragraphs of Article 9.1 require the "*provision by* governments or their agencies",[127] the "*sale or disposal by* governments or their agencies",[128] the "*provision of* subsidies",[129] "charges *provided or mandated by* governments".[130] The Panel considers that this difference must have some meaning. In the Panel's view, a key difference exists as regards both (i) the *nature* of the involvement and (ii) the *extent* of the involvement by government. First, governments or their agencies under paragraph (c) need not necessarily themselves directly *provide*

[123] Black's Law Dictionary (5th Edition), page 182.
[124] Based on the New Shorter Oxford English Dictionary meaning of "authority" (page 151).
[125] New Shorter Oxford English Dictionary, page 950.
[126] The Panel notes that none of the parties has examined in much detail how "financing" by virtue of governmental action should be interpreted.
[127] Article 9.1(a) of the *Agreement on Agriculture*.
[128] Article 9.1(b) of the *Agreement on Agriculture*.
[129] Article 9.1(d) of the *Agreement on Agriculture*.
[130] Article 9.1(e) of the *Agreement on Agriculture*.

subsidies or goods or services at reduced rates. The government or its agencies are merely involved in the *financing of* the payment which may exist as a result of the provision of goods at reduced rates. Second, the payments need not necessarily be directly financed *by* governments or their agencies under paragraph (c). Through the exercise of governmental power, they only *establish the conditions which ensure that* the payment, i.e. the transfer of resources from producer to processor, takes place. The governmental action is, in that sense, a necessary condition for the transfer to take place.

6.39 In conclusion, on the basis of the text and context of Article 9.1(c), the Panel considers that for a payment to be "financed by virtue of governmental action", it must be established that a payment would not be financed, i.e. resources would not be transferred from grantor to recipient, *but for* governmental action.

6.40 This textual and contextual meaning coincides with the Appellate Body's interpretation of this term in its report on *Canada – Dairy* as referring to action which is "*indispensable*" to the financing of the payment.[131] An action is indispensable when it is necessary or vital to a result which could not take place without it. Although it cannot be inferred from the Appellate Body report in *Canada – Dairy* that the Appellate Body meant to equate "by virtue of" with "indispensability" as a matter of general interpretation, the Panel does consider that, having regard to the text and context of Article 9.1(c), it does constitute an appropriate standard to be applied under Article 9.1(c) in this case, as it did in the original case.

*(iii) General analysis by the Panel*

6.41 The question which the Panel needs to address is the following: would milk processors for export have access to lower priced commercial export milk in Canada *but for* governmental action? Put another way, have the Canadian government and its agencies taken action which is *indispensable* for the lower priced milk to be available to processors for export?

6.42 The Panel considers that this standard would be met if it can be demonstrated that governmental action, *de jure* or *de facto*: (i) prevents Canadian milk producers from selling more milk on the regulated domestic market, at a higher price, than to the extent of the quota allocated to them; and (ii) obliges Canadian milk processors to export all milk contracted as lower priced commercial export milk, and, accordingly, penalizes the diversion by processors of milk contracted as commercial export milk to the domestic market. As explained below,[132] only if both those requirements were to be met, governmental action could be said to be indispensable for the transfer of resources to take place: the lower priced commercial export milk would not have been available to Canadian processors for export *but for* these governmental actions, taken together.

6.43 When a producer decides whether to produce for the domestic market or the export market, it can be assumed that he will try to maximize his profits. The Panel notes in this respect that the parties have submitted conflicting data on milk producers' average costs of production and their related capability to produce profitably for export.[133] According to Canada, the information provided by the complainants is intended to convince the Panel that producers are *forced* to sell milk into the commercial export market because absent government compulsion to do so, they would not sell into

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[131] Report of the Appellate Body on *Canada – Dairy*, paragraph 120.

[132] See paragraphs 6.43-6.48 below.

[133] According to the United States, less than 1 per cent of Canadian producers could cover costs of production at export prices of around C$30/hl (United States' Second Submission, paragraph 13 and United States' Exhibit 24), whereas Canada asserts that these figures are inadequate and argues that over 30 per cent of Canadian producers could cover their costs of production at a price of C$31.53/hl (Canada's Oral Statement, paragraphs 17-22 and Canada's Exhibit 26).

that market at a loss.[134] Canada also asserts that government does not direct, compel, *or even encourage* producers to sell into the commercial export market. Thus, according to Canada, the reasons why certain producers sell into the commercial export market and other producers do not sell into that market are irrelevant.[135]

6.44 The Panel makes the following observations in this respect. First, under this Panel's, and the Appellate Body's, interpretation of "by virtue of governmental action" as referring to governmental action which is "indispensable to" the financing of a payment, it is not necessarily required that a government "forces", "directs", or "compels" producers to sell into the commercial export market. What is required is that producers would not sell into the commercial export market *but for* governmental action. This requirement is quite different from the one advanced by Canada. Whether the government "forces" or merely "encourages" producers to sell into the commercial export market are *qualifications* of the causal relationship required under Article 9.1(c). The "financed by virtue of" requirement, however, does not necessarily qualify the causal relationship between governmental action and payment in the way suggested by Canada. It only requires that, independently of the nature of the governmental action, it must be indispensable for the resources to be transferred. What is indispensable in terms of governmental action may vary from one case to another.

6.45 Second, the Panel disagrees with Canada that producers in this case would not be, at least, "encouraged" by government to sell into the commercial export market if the existence of the above two categories of governmental action would be established. Indeed, in the Panel's view, if the existence of the above measures were to be established, the choice left to the Canadian producer is not a real choice. Why would the economically rational producer sell other than for the domestic market at an average price of about C$53/hl in the absence of such regulation? Would the economically rational producer rather sell commercial export milk in the C$30/hl range, under class 4(m) in the C$10/hl range, or destroy his production? In the Panel's view, this is not tenable. The economically rational producer will sell for export only if he cannot sell to the domestic market, either because his quota is filled, or he anticipates that it will be filled,[136] or because he does not have any quota.[137] Arguing the opposite is disregarding the basic assumption that the economic behaviour of a producer is premised on profit-maximization. The reasons why producers in Canada sell into the commercial export market are therefore not "irrelevant", as Canada would argue: if the existence of the above measures can be established, the "reason" would be the governmental action driving producers to the economically second-best option of producing for export. This reason is, in the Panel's view, highly relevant, because it would establish that producers choose the economic second-best option as a totally rational and predictable reaction to government action taking away the first-best option.

6.46 Therefore, the fact that milk has to be *pre-committed* or *first-out-of-tank* for it to be exported does not affect the Panel's analysis in paragraph 6.42. Canada argues that by pre-committing milk to export, producers are required to decide how to allocate their production in advance, before knowing whether they will exceed their domestic quota. According to Canada, this demonstrates that commercial export milk is not milk produced above the domestic quota, and that the decision to produce for export is a commercially free one. In the Panel's view, however, these pre-commitment and first-out-of-tank requirements would not change the fact that the decision to sell for the export market would *not* be based on purely commercial considerations if the above governmental action can

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[134] Canada's Oral Statement, paragraph 17.
[135] *Id*., paragraph 18.
[136] See paragraph 6.47 below.
[137] The Panel notes that at this time more than 99,5 per cent of Canadian producers have chosen not to sell exclusively milk for the commercial export market (Canada's reply to Question 3). The 74 producers who do not hold quota and do exclusively produce for the commercial export market, accounted for 0,08 per cent of total milk production in Canada between August 2000 and February 2001 (Canada's reply to Question 21).

be established. A decision based on purely commercial considerations will maximize profit. Selling for export, rather than for the domestic market, does not maximize profit, *unless the first-best profit-maximizing option has been foreclosed by governmental action*. Inevitably, if a producer decides "in advance" to produce for the second-best option, it is because he knows that the first-best option will, at some point, no longer be available. According to Canada, producers can calculate and "pre-plan" their production for export.[138] If this assertion by Canada is true, then a producer who regularly – and knowingly – produced surplus-milk in the past, will know whether he will be producing milk above his quota in the future. Consequently, that producer, following Canada's assertion, would be able to anticipate whether his production will exceed the quota, and "pre-commit" that portion to export. If the decision to pre-commit for export was a truly commercial one, i.e. the first-best option, producers would produce for export rather than fill their quota. Producers in Canada who pre-commit milk for export, however, continue to meet their domestic quota.[139]

6.47 Finally, the complainants have argued that the regulatory requirement to use exclusively electronic bulletin boards for all export milk transactions in Ontario and Quebec is part of the governmental action by virtue of which the payment is made. The Panel notes that the bulletin boards physically bring together offer and demand for commercial export milk, and, in that sense, are instrumental in the conclusion of export milk contracts. The Panel does not see, however, how the use of such bulletin boards, mandatory or otherwise, could be *indispensable* to the provision of lower-priced milk. In the Panel's view, it would be the governmental action referenced at paragraph 6.42 which would be indispensable to the provision of lower-priced milk. The very assertion by the complainants that payments on export milk are financed by governmental action in the other provinces, where those bulletin boards either are not in place, or, as in the case of Manitoba, their use is not mandatory, would appear to confirm this. All other things remaining the same, if a payment could be financed by virtue of governmental action in provinces where no bulletin boards are in place or their use is not mandatory, those bulletin boards could then not be said to be "indispensable" to the financing of the payment in the two provinces where they do exist and their use is mandatory. At this stage, therefore, the Panel does not consider that the mandatory and exclusive use of electronic bulletin boards for commercial export milk in Ontario and Quebec would appear to be indispensable to making commercial export milk available to processors at reduced rates.

6.48 Thus, the Panel considers that the above governmental action, if proven, would drive milk producers in Canada to sell milk produced outside their quota at a lower price into the export market. The fact, however, that *producers* are driven by governmental action to sell milk produced outside their quota into the export market would not necessarily be sufficient to ensure that such milk effectively ends up in the export stream. Anti-diversion measures need to be put in place and enforced to ensure that *processors* do not divert commercial export milk back to the domestic market. If processors were allowed to market milk contracted for export by producers on the domestic market, they would have a commercial incentive to do so. Since processors buy commercial export milk at prices approximately 40 per cent lower than domestic market prices, they could, by sourcing milk on the export market and subsequently marketing the processed product on the domestic market, reduce the cost of raw material by 40 per cent and substantially increase their profit margins. As a result, it is unlikely that the same amounts of lower priced commercial export milk would end up in the export stream. Thus, *but for* governmental action obliging Canadian milk processors to export all milk contracted for export, and, accordingly, penalizing the diversion of commercial export milk to the domestic market, there would be no payment on the export of milk. Therefore, only if the Panel were also to find that governmental action obliges Canadian milk processors to export all milk contracted

[138] Canada's Rebuttal Submission, paragraph 54; Canada's First Submission, paragraphs 42, 53-54.

[139] The fact that 74 out of approximately 18,900 Canadian producers produce exclusively for export without having domestic quota (Canada's reply to Question 3) does not affect the Panel's conclusion. As stated earlier, these producers account for only 0,08 per cent of Canadian milk production.

as commercial export milk, and, accordingly, penalizes the diversion of commercial export milk to the domestic market, a payment on Canadian dairy exports could be said to be "financed by virtue of governmental action."

6.49 In conclusion, the two categories of governmental[140] measures referred to at paragraph 6.42 above, if proven, in and of themselves, would be considered indispensable to the financing of the payment on the export of milk. The Panel will now turn to an analysis of the claims that these two categories of governmental measures do effectively exist in Canada.

*(iv) Does governmental action prevent Canadian producers from selling milk produced outside their quota on the domestic market?*

6.50 In principle, dairy producers in Canada can only market their milk on the domestic market to the extent of the quota they have been allocated.[141] Consequently, and subject to the Panel's considerations below,[142] a Canadian dairy producer is in principle prevented from marketing his milk on the domestic market outside the quota allocated to him.

6.51 Canada argues, however, that this governmental restriction is mitigated by (i) the possibility to sell milk under Class 4(m) (animal feed), and (ii) the possibility for producers to trade and/or lease additional quota among each other.

6.52 First, as regards the Class 4(m) option, the evidence on the record shows that Class 4(m) sales are a commercially far less attractive option as compared to quota sales or commercial export sales. Canada has confirmed that the average Class 4(m) price is C$10/hl, i.e. about 20 per cent of the average quota milk price and about 30 per cent of the average commercial export price.[143] It follows that, if a rational producer were to be given the choice between selling for the domestic quota market or the commercial export market and selling under Class 4(m), he would, absent exceptional circumstances, never sell milk under Class 4(m). Not surprisingly, Class 4(m) sales constitute a very small portion of total milk sales in Canada (less than 1 per cent[144]). The theoretical choice offered to the producer under Class 4(m) is therefore not of such a nature as to mitigate the governmental restriction on production for the domestic milk market.

6.53 Second, as confirmed by Canada, the fact that producers are free to trade quota *among each other* cannot in any way affect the ceiling of *total quota volume* set by the government.[145] The trading among producers of individual quota always takes places below that ceiling, and inter-producer quota transactions do not increase the total volume of available quota. According to Canada, "quota is

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[140] The Panel considers that the entities involved in the adoption and/or enforcement of the measures referred to in paragraph 6.42 above do not raise questions as regards their qualification as "governmental". These entities, i.e. the federal and provincial governments, the CDC, the CMSMC and the provincial marketing boards, were all found to meet the "governmental" requirement in the Panel report on *Canada –Dairy* (paragraphs 7.73-7.80), and the Panel's underlying reasoning and its finding with respect to the governmental character of the provincial marketing boards was confirmed by the Appellate Body (paragraphs 93-102). The Panel considers that no change in the source of these entities' powers or in the functions conferred upon them can be observed which would justify changing the qualification of their action as "governmental".

[141] This is not controversial. See, for instance, Canada's First Submission, paragraphs 7, 24, 31, 41. See also the report of the panel on *Canada – Dairy*, paragraph 2.20.

[142] See paragraphs 6.52-6.53 below.

[143] Canada's reply to Question 2b.

[144] *Id.*

[145] Canada's reply to Question 4(a)(i). Only government, not inter-producer quota transactions, can change the total quota volume. The CMSMC automatically adjusts MSQ for the domestic market to reflect changes in domestic demand using an agreed formula (Canada's reply to Question 15(a)).

always available to those producers willing to purchase/lease additional quota who bid *at or above* the market price for quota."[146] This may be true. However, if demand for a – by definition – scarce product such as quota is strong, the price of additional quota is likely to be high. When demand increases, supply remaining the same, the price can be expected to increase as well. As a result, the cost of trading additional quota would exceed the profit its use may generate, and the purchasing or leasing of additional quota would no longer be a profit-maximizing one.[147] Canada has confirmed that between August 2000 and February 2001, only about 3.85 per cent of originally allocated quota in Canada changed hands.[148] The Panel also notes that Canada had asserted, but not documented, that "over 5 per cent of quota changes hands in Canada every year."[149] The Panel considers that these small proportions may be indicative of the extent to which producers in Canada consider the purchasing or leasing of quota a commercially viable alternative. The Panel considers, therefore, that the theoretical choice offered to the producer to purchase or lease additional quota is not of such a nature as to mitigate the governmental restriction on production for the domestic milk market.

6.54 In conclusion, the Panel considers that, for the reasons set out above,[150] Canadian dairy producers are, at least *de facto*, prevented by governmental action from freely marketing outside-quota milk on the domestic market.

*(v) Does governmental action oblige Canadian milk processors to export all milk contracted as commercial export milk, and, accordingly, penalize the diversion of commercial export milk to the domestic market?*

6.55 Arguments have been advanced by the complainants concerning both federal and provincial regulatory provisions. The Panel will first address the arguments made concerning the federal Regulations, and thereafter the arguments made concerning the various provincial provisions.

The federal Dairy Products Marketing Regulations

6.56 The United States submits that although there is no explicit prohibition on diverting milk contracted for export into the domestic market, to do so would still constitute a violation of the federal Dairy Products Marketing Regulations (the "federal Regulations"). According to the United States, this is because only milk that precisely meets the definition of "commercial export milk" is exempt from the federal Regulations. Part of the definition of "commercial export milk" under section 2(1)(b) is that the milk must be "marketed in a province set out in the schedule and *in a manner that is consistent with exclusions from the dairy product marketing laws in that province*." Thus, in the view of the United States, if commercial export milk is diverted into the domestic market in violation of provincial regulations, it would no longer fall within the exclusion for "commercial export milk" and therefore would be subject to domestic regulation and the seizure power of the federal inspectors.[151]

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[146] Canada's reply to Question 4(a)(ii), paragraph 11. Emphasis added.

[147] The Panel notes that New Zealand has asserted, on the basis of New Zealand's Exhibit 15, that "the right to produce 1 kg of butterfat per day can cost over C$25.000" (New Zealand's Rebuttal Submission, paragraph 4.18), and that Canada has not contested this assertion.

[148] Canada's reply to Question 4b.

[149] Canada's Rebuttal Submission, footnote 53. Canada's Oral Statement, paragraph 14.

[150] Paras. 6.50-6.53.

[151] United States' Second Submission, paragraph 49. In its First Submission, the United States had also asserted that it results from new section 7(4) of the federal Regulations that "any person who knowingly diverts commercial export milk for final consumption in Canada violates the [federal] Regulations." (footnote 62) According to the United States, Section 11(1) of the federal Regulations "empowers inspectors appointed under the Canadian Dairy Commission Act to seize any dairy product that the inspector believes on reasonable grounds was marketed in interprovincial or export trade in contravention of the [federal] Regulations. Since the [federal] Regulations prohibit the diversion into Canada's domestic market of any milk committed to export, the

The United States has provided the Panel two examples of situations where, in the United States' view, milk that falls out of the defined exemption for "commercial export milk" could trigger a violation of federal Regulations and, thus, seizure by the federal inspector of the milk, or the products into which it was manufactured, under section 11(1):[152]

> (a) if the processor purchased milk from a producer without a federal license (since none is required under federal regulation for commercial export milk): the diversion of this milk would entail a violation of section 7(3), because, if the milk no longer meets the definition of "commercial export milk," then section 7(3) would apply and a federal license would be required.
>
> (b) if the processor is not identifying the diversion of milk in his written records (in other words, the records are incorrect or incomplete): a violation of section 10 would arise because he would not be keeping accurate records.

6.57 Canada confirms that if milk is marketed in a province in a manner that is not consistent with exclusions from the dairy products marketing laws in that province, then it does not meet the definition of commercial export milk in the federal Regulations, and is therefore not excluded from the application of sections 4 to 7 and 8 and 9 of the federal Regulations.[153] As regards the possibility of seizure by federal inspectors in the two examples provided by the United States, Canada has stated that "[a] violation of [the] requirement [to keep books and records under Section 10] cannot be equated to a diversion of commercial export milk into the domestic market."[154]

6.58 The United States and Canada confirm that there is no *de jure* prohibition in the federal Regulations on diverting milk contracted as commercial export milk to the domestic market. As Canada confirms, however, if a sale of commercial export milk into the domestic market were to occur, there would be "financial consequences" for the processor. The processor would pay *twice* for milk: initially at the price contracted under the commercial export contract, and then a second time at the much higher domestic price.[155] The Panel therefore considers that the federal Regulations penalize diversion of commercial export milk to the domestic market through the application of "financial disincentives". These "financial disincentives" exceed the domestic market price and are therefore of a punitive nature. The Panel considers that this penalty, in conjunction with the CDC's auditing power,[156] constitutes an effective government-imposed deterrent to diversion of commercial export milk.

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CDC inspectors (and their provincial counterparts) have been given authority to seize any commercial export milk or cream that based 'on reasonable grounds' is believed to have been sold into the domestic market for final consumption, rather than exported as required by the [federal] Regulations." (paragraph 46). Following the Panel's request to clarify its position regarding those arguments under the federal Regulations, the United States confirmed that it considered its argument regarding section 7(4) moot (United States' reply to Question 5a). The Panel will therefore not address the argument made under section 7(4) of the federal Regulations.

[152] United States' reply to Question 5c.

[153] Canada's reply to Question 5c.

[154] Canada's Comments on the United States' and New Zealand's replies to the Questions of the Panel, paragraph 8.

[155] Canada's reply to Question 5c, paragraph 16. Although Canada does not specify that these "financial disincentives" would result from the application of the federal Regulations, the fact that (i) the information was provided in response to the Panel's specific question regarding the United States' argument under the federal Regulations, and (ii) that Canada makes no reference in its reply to provincial measures, seems to confirm, in the Panel's view, that Canada was referring to the application of the federal Regulations.

[156] The CDC has the authority, pursuant to Section 10 of the federal Regulations, to request every person who is engaged in the production or processing of a dairy product for marketing in interprovincial or

6.59 As regards the possibility of seizure by federal inspectors in the two examples provided by the United States, the Panel considers that, even if the examples were to accurately reflect the operation of the federal Regulations, their relevance to the Panel's assessment is rather limited. In the Panel's understanding, example (a) would ordinarily only apply if the diverted milk has been produced by a producer who does not hold a licence and, therefore,[157] would normally not hold quota. As acknowledged by the United States,[158] the number of those Canadian milk producers that produce without a quota for the export market is extremely small, and so are the quantities they produce. Example (b) does not concern a breach of the federal Regulations by the diversion of commercial export milk to the domestic market, but, rather, by not keeping accurate records. If the diversion of commercial export milk would be accurately reflected in the processor's records, the "financial disincentives" referred to by Canada are likely to kick in, but no breach of Section 10 would occur, and, thus, no milk would be seized.

Provincial Measures

6.60 Both complainants have argued that anti-diversion measures are in place at the provincial level in Canada. They have mostly focused their arguments on the provinces of Quebec and Ontario, given the importance of these provinces in terms of Canadian milk exports.[159] All parties, however, have also submitted or clarified information with regard to other milk-exporting provinces in Canada.

6.61 The Panel takes note of Canada's statement that, under each of the nine provincial regimes governing the purchase and sale of non-quota milk, "all producers and processors in Canada are subject to sanctions for breach of [certain provincial regulatory] requirements. These could include suspension or cancellation of license or in some circumstances penalties […] *and/or financial consequences (i.e. through product re-classification or in the case of commercial export milk, if sold in the domestic market, by becoming part of the domestic classification system*)."[160] (emphasis added)

6.62 The Panel, therefore, accepts as established that diversion of commercial export milk into the domestic market will, at least, result in "financial consequences" in all nine milk-exporting provinces in Canada. The Panel will now turn to an analysis of the individual provinces to determine the level of these financial consequences and the applicability of other sanctions, such as the suspension or cancellation of licences.

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export trade to make available complete and accurate books and records of all matters relating to production or processing. According to new Section 10.1, "[a]ny information made available to the [CDC] under Section 10 does not have to contain pricing or other information on commercial export milk or cream, *except information that is necessary to determine whether it has been marketed for final consumption in Canada*." (emphasis added) If the CDC would not have this authority to verify whether milk contracted as CEM has been diverted to the domestic market, the likelihood that processors could divert CEM without paying the applicable penalties would, of course, be much greater. The assertion by Canada that a CDC audit which takes places after the transaction cannot affect decisions regarding that transaction (Canada's First Submission, paragraph 111) is not convincing: one would not forego the making of an income tax declaration because the tax inspector only audits one's books later on.

[157] Section 7(1) of the federal Regulations provides that the Canadian Dairy Commission shall cause a federal licence to be issued only to a person (a) to whom a share of the federal quota has been allotted; (b) who is registered as a milk producer with, or is licensed as a cream producer by, the Manitoba Milk Producers; or (c) who is licensed as a producer under the Milk Act of Ontario.

[158] United States' Second Submission, footnote 4.

[159] The United States asserts that Quebec and Ontario together account for approximately 80 per cent of Canadian milk exports (United States' First Submission, paragraph 20).

[160] Canada's reply to Question 19(ii).

Quebec

6.63 Decision 7111 of the Régie des Marchés Agricoles et Alimentaires du Québec (the "Régie"), dated 28 July 2000, has amended the provisions of the Milk Marketing Agreement between the Féderation des Producteurs de Lait du Quebec and Agropur (the "MMA Agreement"). The Panel notes that Canada refers to Decision 7111 as either the "relevant legal provisions"[161] or the "relevant regulatory amendment" in Quebec.[162]

6.64 Pursuant to the amended paragraph 2.25 of the MMA Agreement

> All components of milk intended for export markets and covered by a specific commitment between an individual producer and a milk dealer must be exported. Any milk dealer who breaches this obligation is subject to the penalties stipulated in this chapter.

Pursuant to the amended paragraph 2.43 of the MMA Agreement,

> When a milk dealer is unable to show that all the quantities of components of the volume of milk received have been exported or are stored, it must, upon receiving the audit report to this effect, pay to the Federation, subject to the other remedies of the parties to the contract, an amount, per kilogram of component, equal to twice the component price payable in class $3b_2$.

According to the United States, the penalty would equal an amount that would approximately be four times the price that the processor would have paid for milk destined for export.[163] Canada has not contested this assertion.

6.65 The Panel considers that this penalty is of a punitive nature and, in conjunction with the CDC's auditing power, constitutes an effective government-imposed deterrent to diversion of commercial export milk.

Ontario

6.66 The United States has submitted a document entitled "Ontario Dairy Export Exchange Mechanism", provided by the Canadian government and "describing the dairy export mechanisms for [….] Ontario."[164] In its reply to a request for clarification by the Panel following its meeting with the parties, however, Canada has explained that this document is a draft document, and that it has been replaced by a different version,[165] which does not contain the provisions the United States referred to.[166] Notwithstanding the fact that the document submitted by the United States has never been more than a draft, the United States opines that "[i]n any event, the statements in the document should be treated as admissions by Canada for the purposes of this proceeding."[167] The Panel does not agree with the United States, and will only consider the final version of the document.

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[161] Canada's reply to Question 19(i).

[162] Canada's reply to Question 19(ii). Canada also lists Decision 7111 as such (Canada's Exhibit List, page iv).

[163] United States' First Submission, paragraph 37.

[164] United States' Exhibit 6.

[165] Canada's reply to Question 6.

[166] "Ontario Dairy Export Contract Exchange Mechanism", contained in Canada's Exhibit 32, New Zealand's Exhibit 7.

[167] United States' reply to Question 6.

6.67 Section F.1 of the Ontario Dairy Export Contract Exchange Mechanism provides,

> All buyers will keep and provide to the auditor of the domestic market all records required to demonstrate that all components provided pursuant to an export contract have either been duly exported or are being held in inventory.

6.68 The Panel considers that this provision clearly implies the existence of an obligation for processors to export milk contracted through the Ontario Dairy Export Contract Exchange Mechanism. Although Canada has characterized the document as a "private industry agreement",[168] the Panel notes that one of the parties to this agreement is DFO (Dairy Farmers of Ontario), a provincial marketing board, which the Panel in its report on *Canada – Dairy* has characterized as an agency of the Canadian government,[169] and that the agreement, as acknowledged by Canada, "is referenced in the DFO regulations as part of the definition of milk."[170]

6.69 Second, Section 1(b) of DFO Milk General Regulation 09/00[171] sets forth the definition of "export contract milk" as "pre-committed first milk out of the producer's bulk tank that is the subject of a commercial export contract made through the export contract exchange operated by the Third Party Administrator and is deemed to be the first milk out of the tank." The parties agree that, as a result, if milk is not delivered to export it would no longer constitute export contract milk and would therefore be subject to domestic regulation.[172]

6.70 DFO Milk General Regulation 09/00 does not set forth a specific sanction on diversion, but Section 3 of DFO Milk Pricing Regulation 08/00 provides that "export contract milk" is exempt from the provisions set forth in that regulation. If the milk no longer qualifies as "export contract milk" (because it was not exported), the processor would be subject to Section 4 which states that "[a]ll classes of milk supplied to a processor shall be sold by the DFO and bought by the processor at price equal to the total of the amount per kilogram of [milk product] as set out in [the relevant column of Schedule 1]." According to the United States, this price would be paid in addition to the export price that has already been paid by the processor, who would end up paying approximately C$90/hl. Canada has not contested this assertion.

6.71 The Panel considers that the imposition of a severe monetary penalty under DFO Regulations in case of diversion, in conjunction with the CDC's auditing power, constitutes an effective government-imposed deterrent to diversion of commercial export milk in Ontario.

6.72 Finally, the United States refers to Section 5(4) of the DFO Milk General Regulation 09/00, which provides that:

> DFO may refuse to grant or renew or may suspend or revoke a licence […] where the applicant or licensee has failed to comply with or has contravened the Act, the Regulations, the Plan or any Order or Direction of DFO.

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[168] Canada's reply to Question 6.

[169] Report of the panel on *Canada – Dairy*, paragraphs 7.76-7.78.

[170] Canada's reply to Question 6.

[171] The Panel takes note of Canada's statement that "DFO Milk General Regulation 15/00 is the most up-to-date version of the General Regulation, but makes no significant changes to DFO Milk General Regulation 09/00 with respect to provisions involving export contract milk." (Canada's First Submission, Annex 5, footnote 2). In view of this statement, and considering that the exchanges between the parties have drawn upon DFO Milk General Regulation 09/00, the Panel will use DFO Milk General Regulation 09/00 as a basis for its analysis.

[172] United States' reply to Question 16. Canada's reply to Question 6.

According to the United States, pursuant to Section 5(4) failure to export milk so committed can lead to the revocation of the licence of a milk *producer* in Ontario.[173] Canada replies by stating that the DFO "cannot use licensing as a means to enforce the terms of private commercial agreements",[174] and that "the United States is inviting the Panel to speculate that DFO will somehow use its health and safety licensing authority for extraneous and illegal purposes, namely, to somehow 'punish' for any 'breach' of the commercial export exchange."[175]

6.73 The Panel understands that, according to the United States, DFO could punish a *producer* for diversion of commercial export milk to the domestic market by a *processor.* On the one hand, the Panel has difficulty seeing how, as a practical matter, the producer of a fungible product such as milk could be identified on the basis of the processed product it was used in, and, if he can be identified, why he would be punished for a regulatory breach by a processor. On the other hand, the Panel notes that Canada's replies to the Panel's questions on the matter have not fully enabled the Panel to make its assessment in this respect.[176] The Panel is mindful of the fact that Canada has the burden of proof pursuant to Article 10.3, and that, therefore, it is up to Canada to raise a presumption that what it asserts is true. Nevertheless, the Panel will not enter into speculations as regards the interpretation and application of this aspect of Ontario law, as it already has found that the imposition of a severe monetary penalty under DFO Regulations in case of diversion, in conjunction with the CDC's auditing power, constitutes an effective government-imposed deterrent to diversion of commercial export milk in Ontario.

Other Canadian Milk-Exporting Provinces

6.74 The Panel has reviewed the evidence submitted by the parties with respect to the provincial regulatory instruments governing commercial export milk in the remaining 7 milk-exporting provinces. On the basis of that review, the Panel has found that in each of these provinces:

(a) commercial export milk is clearly defined as milk that must be exported;[177]

(b) milk that meets this definition of commercial export milk is exempted from domestic regulation;[178]

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[173] United States' First Submission, paragraph 80. United States' Second Submission, paragraph 47.

[174] Canada's First Submission, paragraph 109.

[175] Canada's Second Submission, paragraph 44.

[176] Questions 6, 7 and 8 by the Panel, and Canada's replies to these questions. In questions 7 and 8, the Panel had asked Canada to include in its replies any regulatory instruments referenced in its reply to Question 6, regarding the "Ontario Dairy Export Exchange Mechanism". In its reply to Question 6, Canada stated, *inter alia*, that "*the exchange set out in this agreement is […] referenced in the DFO regulations* as part of the definition of milk, the marketing of which is deregulated when marketed through that exchange." Although the Panel would therefore have expected Canada to include the relevant "DFO Regulations" in its replies to Questions 7 and 8, Canada did not do so.

[177] British Columbia Milk Marketing Board Regulation Amendments, BC Reg 167/94, section 1; Alberta Dairy Board Regulation section 1(2)(e.1); Saskatchewan Milk Control Regulations, Part I section 2 (f.1, f.2); Manitoba Milk Producers' Marketing Export Contract Milk Exemption Order, sections 1, 2; New Brunswick Milk Marketing Board Exemption Order 11, section 2; Nova Scotia Regulation Respecting Contracted Exports of Dairy Products, Schedule 13, section 1(a); Prince Edward Island Milk Marketing Regulation Amendments, EC2000-785, section 1.

[178] British Columbia Milk Marketing Board Regulation Amendments, BC Reg 167/94, section 7.1(2); Alberta Dairy Board Regulation section 1(2)(e.1); Saskatchewan Milk Control Regulations, Part II section 3, Part III section 15(2), Part V section 39.7(2); Manitoba Milk Producers' Marketing Milk General Order 301/89, Part I, section 1; New Brunswick Milk Marketing Board Exemption Order 11, section 4; New Brunswick Milk Marketing Board Milk Pricing Order, section 3; Nova Scotia Regulation Respecting Contracted Exports of

(c) milk that was contracted as commercial export milk and subsequently diverted to the domestic market becomes subject to domestic regulation, and, as a result, a processor would be obliged to pay the higher domestic price *on top of* the price already paid for the commercial export milk.[179]

6.75 The Panel considers that this penalty is of a punitive nature and, in conjunction with the CDC's auditing power, constitutes an effective government-imposed deterrent to diversion of commercial export milk.

6.76 The Panel has not found that diversion of commercial export milk in those provinces may lead to seizure by the provincial authorities. The United States has in that respect only drawn the Panel's attention to the seizure power of the Prince Edward Island Marketing Board pursuant to Section 3(q), Chapter N-3 of the Prince Edward Island Marketing Regulations.[180] That provision gives the Prince Edward Island Marketing Board the power "to seize and dispose of any milk marketed in violation of any order of the Board." Consequently, if diversion would constitute a violation of "an order of the Board", it would trigger the possibility of seizure. The Panel is mindful of the fact that Canada has the burden of proof pursuant to Article 10.3, but considers that it does not need to make a finding on this particular issue, as it has already found that the financial penalty for diversion is of a punitive nature and, in conjunction with the CDC's auditing power, constitutes an effective government-imposed deterrent to diversion of commercial export milk.

*(vi) Conclusion*

6.77 In conclusion, the Panel finds that the payment is "financed by virtue of governmental action", in that lower-priced commercial export milk would not be available to Canadian processors *but for* the above federal and provincial actions (i) restricting supply on the domestic milk market, obliging producers, at least *de facto*, to sell outside-quota milk for export, and (ii) obliging processors to export all milk contracted as commercial export milk, and penalizing diversion by processors of commercial export milk into the domestic market.

(d) Payment "on the export of an agricultural product"

6.78 The lower priced commercial export milk is only available to processors if the milk is contracted for export and effectively exported. Only by contracting for export and effectively exporting milk can producers and processors engage in transactions outside the regulatory framework of price floors and quota ceilings applicable to domestic market milk transactions in Canada. The Panel, therefore, finds that a clear export contingency exists, and that the payment is made "on the export of an agricultural product."

(e) Conclusion regarding Article 9.1(c)

6.79 For the reasons set out above,[181] the Panel finds that a payment on the export of milk is financed by virtue of governmental action in Canada, within the meaning of Article 9.1(c).

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Dairy Products, Schedule 13, section 2; Prince Edward Island Milk Marketing Regulations, MMB00-02, section 3, 4; Prince Edward Island Milk Marketing Regulation Amendments, EC2000-785, section 3.1(1).

[179] In certain regulatory instruments, it is explicitly stipulated which domestic market price will have to be paid by the processor: British Columbia Milk Marketing Board Regulation Amendments, BC Reg 167/94, section 7.2; Saskatchewan Milk Control Regulations, Part IV, section 39(4)(4).

[180] United States' reply to Question 19.

[181] Paragraphs 6.7-6.78.

### 3. Article 3.3

6.80 Having found that CEM exports are being subsidized within the meaning of Article 9.1(c), the Panel recalls the original panel's[182] and Appellate Body's[183] finding that, as acknowledged by Canada,[184] Class 5(d) exports are also subsidized within the meaning of Article 9.1(c). Consequently, if the sum of CEM and Class 5(d) export quantities in the marketing year 2000/2001 were to exceed Canada's quantity commitment levels specified in its Schedule, the Panel would find a breach of Article 3.3.

6.81 According to data provided by New Zealand and the United States, and spanning the period August 2000 – February 2001, Canadian exports of cheese amount to 9,613 metric tons,[185] and exports of other milk products range from 25.600[186] to 28.826[187] metric tonnes. Canada's reduction commitment levels for the marketing year 2000/2001 are set at 9,076 and 30.282 metric tons, respectively. The United States contended that these figures do *not* include exports under Canada's IREP.[188] As a result, according to this data, Canadian cheese exports would already be subsidized in excess of Canada's reduction commitment levels specified in its Schedule as of February 2001. According to Canada, however, these figures *do* include exports under Canada's IREP.[189] According to Canada, Canadian exports of other milk products between August 2000 and February 2001, *excluding* IREP exports, amount to 25,538 metric tons,[190] and Canadian cheese exports for the same period, *excluding* IREP exports, 7,986 metric tons.[191] As a result, according to the Canadian data, no export subsidies would have been provided in respect of any dairy exports in excess of Canada's quantity commitment levels specified in its Schedule as of February 2001.

6.82 In the light of such conflicting evidence, the Panel requested each of the parties to explain precisely how the data they had used was arrived at and to refer to the exact source and documentation which was used for its computation. The Panel also requested the parties to provide the available statistical data, as well as the source and documentation used for its computation, on total cheese exports from Canada for the months following February 2001, both including and excluding IREP exports.[192] The replies by the parties did not enable the Panel to determine whether or not the figures regarding dairy exports for the period August 2000 – February 2001 included IREP exports.[193] Canada, however, did provide the Panel with data on cheese exports for the months of

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[182] Report of the panel on *Canada – Dairy*, paragraph 7.113.
[183] Report of the Appellate Body on *Canada – Dairy*, paragraph 124.
[184] Canada's reply to Question 23a, paragraph 1.
[185] New Zealand's Exhibit 4. United States' Exhibit 1.
[186] New Zealand's Exhibit 4.
[187] United States' Exhibit 1.
[188] United States' Oral Statement, paragraph 29.
[189] Canada's Rebuttal Submission, paragraph 50. Reiterated in Canada's reply to Question 23a, paragraph 2.
[190] Canada's reply to Question 22.
[191] *Id.*
[192] Panel's Question 23.
[193] In its reply to Question 23, New Zealand "note[d] that [9,613 tons] is the same figure used by the United States and that, according to the United States, the statistics used do not include exports derived from the IREP, although New Zealand has not been able to confirm this independently." In its reply of 22 June 2001 to Question 23 (paragraph 6), Canada explained that "although Statistics Canada does include IREP data [in the aggregate export data], it does *not* include data on transshipments such as products destined for ship-stores or products-in-transit, which are the data that Statistics Canada considers as re-export data." In its reply of 25 June 2001 to Question 23, the United States "note[d] that, in its June 22 supplementary answer, Canada now asserts that 're-exports' as reported by Statistics Canada does not include exports under the IREP. This is contrary to our understanding."

March and April 2001. The Panel proceeded to include in its assessment under Article 3.3 this data, which, according to Canada, does not include IREP exports.[194]

6.83 The data provided by Canada in response to the Panel's questions shows that, as of April 2001, exports of cheese under Class 5(d) and CEM together amount to 10,666 metric tons.[195] As stated earlier, Canada's quantity commitment level for 2000/2001 was set at 9,076 metric tonnes. The Panel, therefore, finds that Canada has provided export subsidies in respect of cheese in excess of its quantity commitment level specified in its Schedule, in breach of Article 3.3.

**4. Article 10.1**

6.84 In the alternative to their claims under Article 9.1(c), both complainants have made claims under Article 10.1. The United States invokes the first phrase of Article 10.1, while New Zealand invokes both the first and the second phrase of Article 10.1. The first phrase applies to "export subsidies *not* listed in paragraph 1 of Article 9". The second phrase applies to "non-commercial transactions". As the panel in the original proceedings noted, Article 9.1(c) and the first phrase of Article 10.1 are mutually exclusive, and, accordingly, export subsidies listed in Article 9.1 cannot be found to contravene the first phrase of Article 10.1.[196]

6.85 In addressing the question whether the Panel should exercise judicial economy with regard to the Article 10.1 claims, the Panel notes, on the one hand, the Appellate Body's statement in its report on *Australia – Measures Affecting Importation of Salmon*:

> The principle of judicial economy has to be applied keeping in mind the aim of the dispute settlement system. This aim is to resolve the matter at issue and "to secure a positive solution to a dispute". To provide only a partial resolution of the matter at issue would be false judicial economy. *A panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings in order to ensure effective resolution of disputes to the benefit of all Members*.[197] (emphasis added)

6.86 On the other hand, the Panel notes the statement by the Appellate Body in its report on *EC – Asbestos*:

> The need for sufficient facts is not the only limit on our ability to complete the legal analysis in any given case. In *Canada – Periodicals*, we reversed the panel's

[194] The Panel considers that, under the terms of Article 3.3, it can and, indeed, should take into account this export data for the months of March and April 2001 to determine whether export subsidies have been provided in excess of reduction commitment levels, notwithstanding the fact that these exports took place after the matter was referred by the DSB to the original panel, i.e. after 1 March 2001. It is submitted that the Panel's finding that CEM exports are being subsidized within the meaning of Article 9.1(c) cannot be restricted to exports which took place before that date, but applies to *all* dairy exports traded under the terms and conditions of the CEM scheme. The same reasoning applies to exports which took place under the continued Class5(d) scheme. The Panel does not address claims not made or measures not included in the complainants' requests for establishment of this Panel. The Panel also notes that the United States explicitly stated in its request for establishment of this Panel that "cheese and other dairy product exports during the 2000/2001 marketing year appear to be occurring at monthly levels that, if continued for the remainder of the year, would result in an additional year of subsidized export shipments inconsistent with Canada's obligations." (WT/DS103/16, page2)

[195] Canada's reply to Question 23a.

[196] Report of the panel in *Canada – Dairy*, paragraph 7.118.

[197] Appellate Body report on *Australia – Salmon*, paragraph 223.

> conclusion that the measure at issue was inconsistent with Article III:2, first sentence, of the GATT 1994, and we then proceeded to examine the United States' claims under Article III:2, second sentence, which the panel had not examined at all. However, in embarking there on an analysis of a provision that the panel had not considered, we emphasized that "the first and second sentences of Article III:2 are *closely related*" and that those two sentences are "part of a *logical continuum*."[198] (emphasis added by the Appellate Body)

6.87 Having regard to these considerations, the Panel notes that the facts underlying the Article 9.1(c) and Article 10.1 claims are, in this case, fully co-extensive. In addition, Articles 9 and 10 can be said to be "closely related" and "part of a logical continuum".[199] As a result, should the Panel's findings regarding Article 9.1(c) be subject to appellate review, and should the Appellate Body decide to reverse one or more of the Panel's findings regarding Article 9.1(c), the Appellate Body would still be able to make findings regarding the Article 10.1 claims on the basis of the Panel record. Thus, should the Appellate Body deem it necessary to complete the analysis by making findings regarding Article 10.1 for the purpose of effectively settling this dispute, it could do so notwithstanding the Panel's decision to exercise judicial economy. Accordingly, the Panel's decision to exercise judicial economy in this instance as regards the Article 10.1 claims should not prevent the DSB from making sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings in order to ensure effective resolution of this dispute to the benefit of all Members.

6.88 In conclusion, having made an affirmative finding regarding the Article 9.1(c) claim, the Panel has decided to exercise judicial economy and not to address the Article 10.1 claims.

### 5. Article 8

6.89 Article 8 provides that "[e]ach Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule."

6.90 Since the Panel has found a breach of Article 3.3 (through Article 9.1), it therefore also concludes that Canada has acted inconsistently with Article 8.

## *B. SCM AGREEMENT*

6.91 The United States has argued that, in addition to constituting export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, or in the alternative, Article 10.1 of that Agreement, Canada's measures affecting the exportation of dairy products constitute prohibited export subsidies pursuant to Articles 1.1 and 3.1 of the *SCM Agreement*.

6.92 The Panel has already noted *supra* that the facts underlying the Article 9.1(c) and Article 10.1 claims are, in this case, fully co-extensive. The Panel believes that this conclusion also applies to the facts underlying the claims made under the *Agreement on Agriculture*, on the one hand, and those made under Articles 1.1 and 3.1 of the *SCM Agreement*, on the other. In addition, the Panel considers that Article 9.1 of the *Agreement on Agriculture* and Articles 1.1 and 3.1 of the *SCM Agreement* can be said to be "closely related" and "part of a logical continuum". Thus, the Panel's reasoning set forth

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[198] Report of the Appellate Body on *EC – Asbestos*, paragraph 79. [original footnote omitted]

[199] Article 10.1 requires Members not to apply export subsidies not listed in Article 9.1 in a manner which results in, or which threatens to result in, circumvention of export subsidy commitments, nor to use non-commercial transactions to circumvent such commitments.

*supra*[200] regarding the claims made under Article 10.1 of the *Agreement on Agriculture* is equally relevant for the claims made under Articles 1.1 and 3.1 of the *SCM Agreement.*

6.93 The Panel also recalls, however, that the panel in the original proceedings decided to exercise judicial economy with respect to the SCM claim, because (i) the United States arguments under Article 3 were minimal (in reality only one sentence);[201] and (ii) the United States never invoked or even referred to the rules and procedures contained in Article 4.[202] In addition, the original panel raised the question whether it could examine the Article 3 claim at all given that in the United States' requests for consultations and establishment of the original panel, the United States only invoked Article 30 as a legal basis for consultations and a panel on its SCM claims.[203]

6.94 In the current proceedings, the Panel notes that (i) the United States argued the Article 3 claim more extensively than before the original panel; (ii) explicitly referred in its First Submission to Article 4.7;[204] and (iii) provided a statement of available evidence in accordance with Article 4.2 in its request for consultations.[205] The question before the Panel is whether these new elements should lead the Panel to decide *not* to exercise judicial economy, despite the Panel's earlier conclusion that the facts underlying the claims made under the *Agreement on Agriculture* and the *SCM Agreement* are fully co-extensive.

6.95 The Panel considers that it should decide this question in the light of the Appellate Body statement cited above.[206] The Panel should, therefore, only address those claims on which a finding is necessary in order to enable the DSB to make *sufficiently* precise recommendations and rulings so as to allow for *prompt* compliance by a Member with those recommendations and rulings in order to ensure effective resolution of disputes to the benefit of all Members. The question before the Panel can therefore be formulated as follows: if the Panel were not to address the SCM claim made by the United States, would the DSB be prevented from making *sufficiently* precise recommendations and rulings so as to allow for *prompt* compliance by Canada?

6.96 It is submitted that an *affirmative* finding in respect of Article 3.1 of the *SCM Agreement* would affect the specificity of the recommendation to be made by the Panel. In accordance with Article 4.7, if the measure in question is found to be a prohibited subsidy, the panel shall (i) recommend that the subsidizing Member *withdraw* the subsidy without delay, and (ii) specify in its recommendation the *time-period* within which the measure must be withdrawn.[207]

6.97 First, as regards the recommendation to *withdraw* the export subsidy, the Panel notes, on the one hand, that the Appellate Body in *Brazil – Aircraft (Art. 21.5)* analyzed the meaning of the word "withdraw" as follows:

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[200] See paragraph 6.87.
[201] Report of the panel on *Canada – Dairy*, paragraph 7.138.
[202] *Id*., paragraphs 7.139-7-140.
[203] *Id*., footnote 515.
[204] United States' First Submission, paragraphs 116 and 122.
[205] WT/DS103/15.
[206] Appellate Body report on *Australia – Salmon*, paragraph 223.
[207] The Panel notes that, in order to make an Article 4.7 recommendation, it would first need to assess the merits of the SCM claim and make an *affirmative* finding that the measure is a prohibited export subsidy. Only if the Panel were to find that the measure is a prohibited subsidy, Article 4.7 would come into play. As a result, the Panel would need to make an affirmative finding on the SCM claim, and, hence, not exercise judicial economy, *before* it could actually determine whether its recommendation would effectively be more specific.

> […] we observe first that this word has been defined as "remove", or "take away"[208], and as "to take away what has been enjoyed; to take from."[209] This definition suggests that "withdrawal" of a subsidy, under Article 4.7 of the *SCM Agreement*, refers to the "removal" or "taking away" of that subsidy."
>
> […]
>
> In our view, to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".[210]

6.98 On the other hand, the Panel notes that Article 21.1 of the *Agreement on Agriculture* provides,

> The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply *subject to* the provisions of this Agreement (emphasis added),

that Article 8 of the *Agreement on Agriculture* provides,

> Each Member undertakes *not to provide export subsidies otherwise than in conformity with this Agreement* and with the commitments as specified in that Member's Schedule, (emphasis added)

and that Article 3.1 of the *SCM Agreement* provides,

> *Except as provided in the Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited […]. (emphasis added)

6.99 In the Panel's view, it results from Articles 8 and 21.1 of the *Agreement on Agriculture* and Article 3.1 of the *SCM Agreement* that the Panel would not be able to recommend Canada to "withdraw" – as interpreted by the Appellate Body – measures constituting an export subsidy, exclusively in respect of agricultural products, both within the meaning of Article 9.1(c) of the *Agreement on Agriculture* and Article 3.1 of the *SCM Agreement.* Under Articles 3.3 and 8 of the *Agreement on Agriculture*, Canada has the right to provide export subsidies in respect of products specified in its Schedule, *provided that* it does not exceed the budgetary outlay and quantity commitment levels specified therein. Accordingly, if Canada has exceeded its quantity commitment levels, the Panel can only recommend Canada to bring its measures into conformity with its obligations under the *Agreement on Agriculture.*

6.100 Since the Panel, in case it would make an affirmative finding in respect of Article 3.1 of the *SCM Agreement*, would not be able to make the withdrawal recommendation provided for in the first sentence of Article 4.7 of the *SCM Agreement*, the Panel does not need to consider the first sentence of Article 4.7 to determine whether or not it should exercise judicial economy. Having found that it would not be able make a recommendation to withdraw the subsidy, in accordance with the first sentence of Article 4.7, the Panel considers that, *a fortiori*, it would not be able to specify a *time-period for* withdrawal, in accordance with the second sentence of Article 4.7.

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[208] [footnote omitted]
[209] [footnote omitted]
[210] Report of the Appellate Body on *Brazil – Aircraft (Art. 21.5)*, paragraph 45.

6.101 Alternatively, assuming *arguendo* that the Panel could make a recommendation to Canada to "withdraw" the export subsidy, it could, pursuant to Article 21.1 of the *Agreement on Agriculture* and Article 3.1 of the *SCM Agreement*, only do so with respect to that portion of the subsidized exports which exceeds Canada's reduction commitment levels under the *Agreement on Agriculture*. The Panel does not see how such a recommendation to partially withdraw would differ from a recommendation to bring the measure into conformity with the *Agreement on Agriculture*. If it could make such a recommendation of "partial" withdrawal, it could also specify the time-period within which such "partial" withdrawal was to take place. Such a specification of a time-period for "partial" withdrawal, however, would, in the Panel's view, not be necessary for Canada to know what it needs to do in order to ensure prompt compliance. In addition, the Panel notes that the practical relevance of this question should be assessed in the light of the "*Agreed Procedures under Articles 21 and 22 of the Dispute Settlement Understanding in the follow-up to the dispute in Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*" which the parties to the dispute have concluded.[211] Pursuant to these Agreed Procedures, it is envisaged that, if the Appellate Body were to confirm and the DSB to adopt the Panel's recommendations based on the Panel's findings under Article 9.1(c) of the *Agreement on Agriculture*, an Article 22.6 arbitrator would, in any case, relatively soon thereafter decide what level of suspension of concessions or other obligations should be authorized against Canada.

6.102 For the reasons set out above,[212] the Panel considers that, by not making findings on the SCM claims, it will not prevent the DSB from making sufficiently precise recommendations and rulings so as to allow for prompt compliance by Canada. Consequently, having made an affirmative finding regarding the claim made under Article 9.1(c) of the *Agreement on Agriculture*, the Panel has decided to exercise judicial economy and not to address the claims made under Articles 1.1 and 3.1 of the *SCM Agreement.*

## VII. CONCLUSIONS AND RECOMMENDATIONS

7.1 In light of the findings contained in Section VI above, the Panel therefore concludes that Canada, through the CEM scheme and the continued operation of Special Milk Class 5(d), has acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, by providing export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* in excess of its quantity commitment levels specified in its Schedule for exports of cheese, for the marketing year 2000/2001.

7.2 Since Article 3.8 of the DSU provides that "[i]n cases where there is an infringement of the obligations assumed under a covered agreement [including the *Agreement on Agriculture*], the action is considered *prima facie* to constitute a case of nullification or impairment", the Panel concludes that – to the extent Canada has acted inconsistently with its obligations under the *Agreement on Agriculture* – it has nullified or impaired benefits accruing to New Zealand and the United States under this Agreement.

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[211] The Understanding between Canada and the United States is contained in WT/DS103/14. According to the Agreed Procedures, (i) the United States has requested authorization to suspend concessions or other obligations pursuant to Article 22.2 of the DSU against Canada; (ii) Canada has objected to the level of suspension of concessions or other obligations; (iii) the matter has been referred to arbitration pursuant to Article 22.6; (iv) the parties have requested the Article 22.6 arbitrator to suspend its work until either the adoption of the Panel's report or, if there is an appeal, the adoption of the Appellate Body report; and (v) in the event that the DSB finds that Canada has failed to comply with the recommendations and rulings of the DSB or that the measures taken by Canada to comply with the recommendations and rulings of the DSB are inconsistent with the covered agreements as referred to in the Article 21.5 compliance panel request, the arbitrator will automatically resume its work.

[212] Paragraphs 6.95-6.101.

7.3 The Panel *recommends* that the Dispute Settlement Body request Canada to bring its dairy products marketing regime into conformity with its obligations in respect of export subsidies under the *Agreement on Agriculture.*

# VIII. ANNEX

## 1. Abbreviations used for dispute settlement cases referred to in the report

*Australia – Salmon*: Australia – Measures Affecting Importation of Salmon, recourse to Article 21.5 of the DSU, (WT/DS18/RW), adopted 20 March 2000;

*Australia - Automotive Leather*: Australia - Subsidies Provided to Producers and Exporters of Automotive Leather (WT/DS126/R) , adopted 16 June 1999;

*Australia – Automotive Leather*: Australia – Subsidies Provided to Producers and Exporters of Automotive Leather, recourse to Article 21.5 of the DSU (WT/DS126/RW), adopted 11 February 2000;

*Brazil - Aircraft:* Brazil - Export Financing Programme for Aircraft (WT/DS46/R), adopted 20 August 1999;

*Brazil – Aircraft:* Brazil - Export Financing Programme for Aircraft, second recourse to Article 21.5 of the DSU, (WT/DS46/RW), established 16 February 2001;

*Canada - Aircraft*: Canada - Measures Affecting the Export of Civilian Aircraft (WT/DS70/R), adopted 20 August 1999;

*Canada - Aircraft*: Canada - Measures Affecting the Export of Civilian Aircraft (WT/DS70/AB/R), adopted 20 August 1999;

*Canada - Dairy*: Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products, (WT/DS103/R, WT/DS113/R), adopted 27 October 1999;

*Canada - Dairy*: Canada - Measures Affecting the Importation of Milk and the Exportation of Dairy Products, (WT/DS103/AB/R, WT/DS113/AB/R), adopted 27 October 1999;

*EC - Bananas* (Ecuador): European Communities—Regime for the Importation, Sale and Distribution of Bananas - recourse to Article 21.5 of the DSU (WT/DS27/RW/ECU), adopted 6 May 1999;

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