

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

Second 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, Second 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 pursuant to the Procedures for the Circulation and De-restriction of WTO Documents (WT/L/452).

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 WT/DS103/14, 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 On 16 February 2001, pursuant to Article 21.5, and as envisaged in the Agreed Procedures, New Zealand and the United States 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 WT/DS103/16, 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. On 28 February 2001, pursuant to Article 22.6 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU), Canada objected to the level of suspension of tariff concessions and other obligations under the GATT 1994 proposed by New Zealand and the United States (WT/DS113/17 and WT/DS103/17, 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 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.

1.9 The report of the Article 21.5 panel was circulated to Members on 11 July 2001. On 4 September 2001, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report on *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (Recourse to Article 21.5 by New Zealand and the United States) and certain legal interpretations developed by the panel. The Appellate Body rendered its report on 3 December 2001.

1.10 On 6 December 2001, New Zealand (WT/DS113/23) and the United States (WT/DS103/23) requested the establishment of a second Article 21.5 panel as they considered that there continued to be "a disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB" between Canada and New Zealand and Canada and the United States, respectively, within the terms of Article 21.5 of the DSU. New Zealand and the United States therefore requested, pursuant to Article 21.5 of the DSU, that this matter be referred to the original panel.

1.11 On 18 December 2001 Canada, New Zealand and the United States agreed to an amendment of the "Agreed Procedures" which provides that the arbitration requested by Canada under Article 22.6 will remain suspended until 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 second Article 21.5 compliance panel request. Alternatively, if the DSB were to find that Canada has complied with the recommendations and rulings of the DSB, the Complainants will withdraw their request under Article 22.2 of the DSU. Further, the amendment stated that following establishment of the second compliance panel in accordance with paragraph 2 of the Understanding, the Complainants will request that, with the exception of all matters relating to Panel composition, the work of the Panel be suspended pursuant to Article 12.12 of the DSU until 18 February 2002.

1.12 At its meeting on 18 December 2001, the Dispute Settlement Body (DSB) decided, in accordance with Article 21.5 of the DSU, to refer to the original panel the matter raised by New Zealand and the United States in documents WT/DS113/23 and WT/DS103/23, respectively.

(i) *Terms of reference*

1.13 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*

1.14 The Panel was composed on 17 January 2002 as follows:

Chairperson: Mr Ernst-Ulrich Petersmann
Members: Mr Guillermo Aguilar Alvarez
Mr Peter Palečka

1.15 Argentina, Australia and the European Communities reserved their third party rights.

1.16 The Panel held a meeting with the Parties on 22-23 April 2002 and with the Third Parties on 23 April 2002. The report of the Panel was submitted to the Parties on 24 June 2002.

II. FACTUAL ASPECTS

(i) *Previous system*

2.1 Under the Canadian supply management system, introduced on 1 August 1995, a processor who wished to export 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) *Canada's implementation measures*

2.2 Canada's implementation of the rulings and recommendations of the DSB left in place the domestic price support mechanism and production quota but eliminated Special Milk Class 5(e) and restricted exports of dairy products under Special Milk Class 5(d) to Canada's export subsidy commitment levels.¹ Canada also created a new class of domestic milk, Class 4(m), under which any over-quota milk can be sold as animal feed at a regulated price on the domestic market.² In addition, Canada deregulated milk for export processing (other than milk exported under Special Milk Class 5(d)) by introducing a new category of "commercial export milk" (CEM), by definition exempt from the pricing regulations applicable to milk destined for the domestic market and destined for export. There are no volume, pricing or timing restrictions on such exports.

2.3 The diversion of CEM or of products made therefrom onto the domestic market is prohibited and subject to penalties. Under pre-commitment contracts, producers decide in advance of production how much milk to sell as CEM which is then delivered first out of the tank to processors.³ Price and volume of CEM are negotiated directly between the processor and the producer.⁴ The governments in Ontario and Quebec require that all export participants operate through a single commercial export exchange.⁵ These "bulletin boards" are part of the operational framework within which commercial export transactions take place.⁶

¹ Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)* WT/DS103/AB/RW and WT/DS113/AB/RW, paras. 4 and 79.

The full titles of the relevant panel and Appellate Body reports are provided in the Annex on page 91.

² *Ibid.*, para. 4.

³ *Ibid.* The panel in *Canada - Dairy (Article 21.5 – New Zealand and US)* noted that DFO General Milk Regulation 09/00 defines CEM as milk that is pre-committed and first out of a producer's tank.

⁴ *Ibid.*, paras. 4 and 79.

⁵ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.8.

⁶ *Ibid.*

2.4 Pursuant to the *Canadian Dairy Commission Act*⁷, the *Dairy Products Marketing Regulations*⁸ have been modified to exclude CEM and cream from federal licensing⁹, quota¹⁰ and levy requirements¹¹ 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 CEM or cream.¹² As a consequence of the changes made under *the Dairy Products Marketing Regulations* and the *Ministerial Direction*¹³, the regional pooling agreements (the P-9, P-6 and P-4 Agreements) do not apply to CEM. The national pooling agreement, the P-9, provides for a domestic surplus management Class, Class 4(m).

(iii) *Previous panel and Appellate Body judgements*

2.5 In its report 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; ..."¹⁴ 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*.¹⁵ 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).¹⁶ 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.¹⁷ 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.¹⁸

2.6 Considering that Canada had failed to comply with the above-mentioned recommendations and rulings of the DSB by 31 January 2001 or since the expiry of that period, New Zealand and the United States requested consultations with Canada on 2 February 2001 (WT/DS103/15-WT/DS113/15) and subsequently the establishment of a panel pursuant to Article 21.5 of the DSU (WT/DS103/16-WT/DS113/16).

2.7 The Article 21.5 panel submitted its report to the parties on 5 July 2001 (WT/DS103/RW). The panel concluded that Canada had continued to act 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 R.S.C. 1985, c. C-15 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).

⁸ 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 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).

⁹ *Supra*, note 31, s. 3(3) and s. 7 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).

¹⁰ *Ibid.*, s. 4, 5 and 6.

¹¹ *Ibid.*, s. 3(3).

¹² See Order Amending Milk Orders Under the *Agricultural Products Marketing Act*, SOR/2001-16, C. Gaz. 2001.II.67 (Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 3.6).

¹³ Published in Canada Gazette, 3 January 2001.

¹⁴ Para. 8.1(a).

¹⁵ Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 144(b).

¹⁶ *Ibid.*, para. 144(a).

¹⁷ *Ibid.*, para. 145.

¹⁸ 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 para. 9(1)(i) of the CDC Act (Special Milk Class 5(d))." (New Zealand's Exhibit NZ-6)

2.8 On 4 September 2001, Canada appealed certain issues of law covered in the Article 21.5 panel report, pursuant to Article 16.4 of the DSU. The Appellate Body rendered its report on 3 December 2001.¹⁹ In reversing the panel's finding on the correct benchmark for the determination of the existence of "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* and in consequently reversing the panel's findings that the provision of CEM constitutes "payments" and export subsidies under that provision, the Appellate Body also reversed the panel's finding that Canada has acted inconsistently with its obligations under Articles 3.3 and 8 of that Agreement. Because the Appellate Body considered that in light of the factual findings by the panel in *Canada – Dairy (Article 21.5 – New Zealand and US)* it was unable to determine whether or not the measure at issue was an export subsidy within the meaning of Article 9.1(c) and consequently whether or not Canada's measures were consistent with its WTO obligations, it could not complete the analysis of the parties' claims under Article 10.1 of the *Agreement on Agriculture* and declined to examine the consistency of the measure at issue with Article 3.1 of the Agreement on Subsidies and Countervailing Measures (*SCM Agreement*).²⁰

[Parties' arguments in Sections III and IV deleted from this version]

¹⁹ Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*.

²⁰ *Ibid.*, paras. 121, 125, 126 and 127.

V. FINDINGS

A. CLAIMS OF THE PARTIES

1. The Complainants' claims

5.1 New Zealand and the United States claim that Canada's commercial export milk ("CEM") system provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

5.2 New Zealand and the United States claim, in the alternative, that Canada's CEM system provides export subsidies or involves non-commercial transactions that are inconsistent with Article 10.1 of the *Agreement on Agriculture*.

5.3 New Zealand and the United States claim that Canada continues to export subsidized dairy products that exceed or threaten to exceed its export subsidy reduction commitment levels in violation of Articles 3.3 and 8 of the *Agreement on Agriculture*.

5.4 The United States claims that Canada's CEM system provides prohibited export subsidies within the meaning of Article 3.1(a) of the SCM Agreement.

5.5 New Zealand and the United States claim that Canada bears the burden of proof, pursuant to Article 10.3 of the *Agreement on Agriculture*, to establish that no export subsidy has been granted in respect of those quantities of dairy products exported in excess of its export subsidy reduction commitment levels.

2. Respondent's claims

5.6 Canada claims that it does not provide export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture* in respect of CEM.

5.7 Canada claims that it does not provide export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

5.8 Canada claims that it does not provide export subsidies in excess of its export reduction commitment levels contrary to Articles 3.3 and 8 of the *Agreement on Agriculture*.

5.9 Canada claims that it does not provide prohibited export subsidies in respect of CEM within the meaning of Article 3.1(a) of the *SCM Agreement*.

B. CONTEXT OF THIS CASE

5.10 The claims of the Parties in this case concern Canada's measures taken to comply with the recommendations and rulings of the DSB to the effect that Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, through its scheme of Special Milk Classes 5(d) and 5(e), by providing "export subsidies" within the meaning of Article 9.1(c) of that Agreement, in excess of the quantity commitment levels specified in Part IV, Section II of Canada's WTO Schedule.

5.11 The Panel recalls that under its previous system, Canada set a support price for domestic milk tied to a production quota and established Special Milk Class 5(e) for the removal of surplus milk and

Special Milk Class 5(d) for milk and dairy products produced under quota for the export market.²²³ Prices for Classes 5(d) and (e) were negotiated and established on a case-by-case basis between the Canadian Dairy Commission ("CDC") and the processors/exporters.²²⁴ The original panel in *Canada – Dairy* found that milk under Classes 5(d) and (e) was made available to processors for export at a significantly lower price than the price of milk *for domestic use*.²²⁵ In those proceedings, the United States submitted factual evidence showing that the price for cheese was CDN \$27.28 in Special Milk Class 5(d) and CDN \$26.87 in Special Milk Class 5(e) between January to June 1997.²²⁶ All Parties also agreed that Canada's exports of butter, cheese and "other milk products" exceeded Canada's reduction commitment levels for both marketing years at issue (1995-1996 and 1996-1997).²²⁷

5.12 This Panel recalls that the measures taken by Canada to implement the DSB rulings and recommendations, at issue again in this second recourse to Article 21.5 of the *DSU*, left in place the domestic price support mechanism tied to a production quota but eliminated Special Milk Class 5(e) and restricted exports of dairy products under Special Milk Class 5(d) to Canada's export subsidy commitment levels.²²⁸ Canada also created a new class of domestic milk, Class 4(m), under which any non-quota milk can be sold only as animal feed at a regulated price.²²⁹ In addition, Canada introduced a new category of milk for export processing known as "commercial export milk" ("CEM"), the price and volume of which are negotiated directly between the processor and the producer.²³⁰ Under pre-commitment contracts, producers decide in advance of production how much milk to sell as CEM that is delivered "first-out-of-the-tank" to processors.²³¹ Milk that is contracted as CEM is exempt from paying the domestic in-quota price and the diversion of CEM and dairy products made from CEM into the domestic market is subject to financial and other penalties.²³²

C. BURDEN OF PROOF

5.13 As noted in the previous section, New Zealand and the United States claim that Canada bears the burden of proof, pursuant to Article 10.3 of the *Agreement on Agriculture*, to demonstrate that no export subsidy has been granted in respect of those quantities of dairy products exported in excess of Canada's export subsidy reduction commitment levels.²³³ Canada does not dispute the application of Article 10.3 in this case.²³⁴

²²³ Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)* WT/DS103/RW and WT/DS113/RW, para. 3.1.

²²⁴ *Ibid.*

²²⁵ Panel Report, *Canada – Dairy* WT/DS103/R and WT/DS113/R, DSR 1999:VI, 2097, para. 7.50.

²²⁶ *Ibid.*, para. 2.51, reproducing US Exhibit 22

²²⁷ *Ibid.*, para. 7.34.

²²⁸ Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)* WT/DS103/AB/RW and WT/DS103/AB/RW, paras. 4 and 79.

²²⁹ *Ibid.*, para. 4.

²³⁰ *Ibid.*, paras. 4 and 79.

²³¹ *Ibid.*, para. 4.

²³² Panel Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, para. 6.77 and Appellate Body Report, *Canada - Dairy (Article 21.5 – New Zealand and US)*, para. 4.

²³³ Para. 3.4 above.

²³⁴ Para. 3.5 above.

5.14 Article 10.3 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."

5.15 The Panel considers, therefore, that with respect to claims made under the *Agreement on Agriculture*, if the Complainants demonstrate that Canada has exceeded its export subsidy reduction commitment levels on certain dairy products, and Canada claims it is not providing export subsidies in relation to those exports, it is then for Canada to establish, pursuant to Article 10.3 of the *Agreement on Agriculture*, that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports exceeding Canada's export subsidy reduction commitment levels.

5.16 On the question of whether Canada has exceeded its reduction commitment levels, New Zealand and the United States have put forward evidence demonstrating that Canadian exports of cheese and "other milk products" in marketing year (August-July) 2000-2001 exceeded those quantities for which Canada has committed to limit its export subsidies. The Complainants also demonstrate that Canada is likely to exceed these quantities in marketing year 2001-2002.²³⁵ The Panel further notes that Canada does not dispute that its exports exceeded the quantity in respect of which it could grant export subsidies for cheese and "other milk products" in 2000-2001 and that they are likely to do the same in 2001-2002.

5.17 Accordingly, the Panel *finds* that the Complainants have established that Canadian exports of cheese and "other milk products" in 2000-2001 have exceeded those quantities in respect of which Canada has committed to limit export subsidies and that they are likely to exceed those quantities again in 2001-2002.

5.18 Having found that Canadian exports of cheese and "other milk products" exceed Canada's reduction commitment levels, and recalling the considerations on the burden of proof as set out in paragraph 5.15 above, the Panel is of the view that an operational interpretation of Article 10.3 requires that the Complainants make a *prima facie* showing that the elements of the claimed export subsidies are present.

5.19 Once the Panel has examined the Complainants' claims and arguments, and provided that the Complainants make out a *prima facie* case that certain elements of the Canadian regulation of its dairy industry constitute export subsidies under either Article 9.1(c) or Article 10.1, it will then be for Canada, pursuant to Article 10.3 of the *Agreement on Agriculture*, since it claims that its exports in excess of its commitment levels are not subsidized, to establish that Canadian exports of cheese and "other milk products" do not benefit from these particular types of export subsidies.

²³⁵ New Zealand's Exhibits NZ-1 and NZ-2; United States' Exhibits US-1. Specifically, the evidence put forward by New Zealand shows exports in excess of commitment levels of 9,692 tonnes for cheese and 16,823 tonnes for "other milk products" for 2000-2001 and an estimated excess for cheese of 8,778 tonnes and 32,600 tonnes for "other milk products" for the year 2001-2002. The evidence put forward by the United States shows an excess of exports of 8,748 tonnes for cheese and of 33,488 tonnes for "other milk products" for 2000-2001 and estimated excess of 9,608 tonnes for cheese in 2001-2002. The Panel notes that the Complainants' figures are provided by marketing year.

D. WHETHER EXPORT SUBSIDIES EXIST WITHIN THE MEANING OF ARTICLE 9.1(C) OF THE AGREEMENT ON AGRICULTURE

1. Introduction

5.20 The Complainants claim that Canada's CEM system provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

5.21 The relevant text of Article 9.1(c) reads as follows:

"The following export subsidies are subject to reduction commitments under this Agreement: ... (c) payments on the export of an agricultural product that are financed by virtue of governmental action ...".

5.22 The Panel notes that the Complainants have focused their arguments under Article 9.1(c) on: (1) whether there are "*payments*"; and (2) if so, whether such payments are "*financed by virtue of governmental action*".

5.23 As for the third element under Article 9.1(c), i.e., whether payments are made "*on the export*" of an agricultural product, the Panel recalls the finding by the panel in the first Article 21.5 *Canada – Dairy* case that since Canadian federal regulations define CEM as milk that must be exported, any payment in relation to CEM is a payment "*on the export*".²³⁶ We further recall that Canada neither disputed nor appealed this earlier finding.²³⁷ We shall therefore not examine this issue further in this proceeding.

5.24 Accordingly, the Panel shall restrict its analysis of whether the Complainants make out a *prima facie* case of the existence of an export subsidy, within the meaning of Article 9.1(c), to the two elements actually contested, i.e., whether there are "*payments*" and, if so, whether such payments are "*financed by virtue of governmental action*".

5.25 Provided we find that the Complainants make a *prima facie* case with respect to the existence of "*payments*", it will then be for Canada to attempt to discharge its burden of establishing that no "*payments*" are being made. Similarly, provided we find that the Complainants make a *prima facie* case that any such payments are "*financed by virtue of governmental action*", it will then be for Canada to attempt to discharge its burden of establishing that it is not by virtue of governmental action that any such payments are financed.

2. Whether there are "payments"

5.26 The Panel recalls that, as found by the panel and confirmed by the Appellate Body in the original *Canada – Dairy* case, a payment includes a "*payment-in-kind*".²³⁸ This was reaffirmed by the panel and the Appellate Body in the first *Canada – Dairy* case under Article 21.5 of the *DSU*²³⁹ and has not been re-argued by the Parties in this second examination under Article 21.5.

5.27 At issue before the panel and the Appellate Body in the first Article 21.5 case was the appropriate benchmark to measure whether or not "*payments*" were being made under Canada's

²³⁶ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.78.

²³⁷ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 62-63.

²³⁸ Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.101; Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 112.

²³⁹ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.12; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 71 and 76.

implementation measures.²⁴⁰ The Appellate Body rejected the Article 21.5 panel's reliance on the regulated domestic price and on world market prices, finding that neither represents an appropriate benchmark for determining whether sales of CEM by producers involve payments.²⁴¹ The Appellate Body stated that the existence of a payment requires a comparison between the prices of CEM and "some objective standard reflect[ing] the proper value" of milk to the producer²⁴², in this case, "the average total cost of production".²⁴³

5.28 The Panel recalls the Appellate Body's reasoning equating "payments" with the transfer of economic resources²⁴⁴ and, on this basis, focusing on whether CEM prices are sufficient to recover average fixed and variable costs of production, and thus on whether producers are able to avoid making losses in the long run.²⁴⁵

5.29 The Panel notes that the Complainants and Canada disagree on how this newly enunciated benchmark of average total cost of production should be interpreted and applied. The Panel, in recalling its analysis in paragraphs 5.18-5.19 and 5.25 above, will first examine whether the Complainants make a *prima facie* showing of the existence of "payments". Provided the Complainants make such a showing, it will then be for Canada, pursuant to Article 10.3 to establish that no "payments" within the meaning of Article 9.1(c) are being made.

(a) Whether the Complainants make a *prima facie* case of the existence of "payments"

5.30 The Complainants ask the Panel to apply the "average total cost of production" benchmark, as enunciated by the Appellate Body, to the determination of whether there are payments in this case.²⁴⁶ Specifically, the Complainants request us to consider that the Appellate Body's cost of production benchmark should be construed as referring to an industry-wide average.²⁴⁷

5.31 For the purposes of applying the Appellate Body's benchmark, the Complainants ask the Panel to rely on survey data collected annually in accordance with the CDC Handbook of COP Principles and Practices ("CDC Guidelines") and used to set the domestic in-quota price ensuring a fair return to efficient dairy producers in the domestic market.²⁴⁸ Complainants contend that the CDC survey data represents a reasonable, albeit conservative, reflection of the cost of production of the Canadian dairy industry.²⁴⁹ They further contend that while the survey data excludes cost of production data for the 30 per cent least efficient producers and for producers with less than 60 per cent of the average annual output in each province²⁵⁰, as well as the cost of domestic quota²⁵¹, the CDC data and Guidelines otherwise account for all the relevant cost elements, i.e., all the fixed and variable costs, of producing a unit of milk.²⁵²

5.32 On the question of which cost elements to include, the Complainants argue that because the Appellate Body referred to *all* fixed and variable costs, imputed costs should be included in such

²⁴⁰ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 74-75, 96, 104.

²⁴¹ *Ibid.*, paras. 82, 85 and 104.

²⁴² *Ibid.*, para. 74.

²⁴³ *Ibid.*, para. 96.

²⁴⁴ *Ibid.*, para. 76.

²⁴⁵ *Ibid.*, para. 87.

²⁴⁶ Paras. 3.11 and 3.55 above.

²⁴⁷ Paras. 3.60-3.61 above.

²⁴⁸ Para. 3.16 above.

²⁴⁹ *Ibid.*

²⁵⁰ Para. 3.18 above.

²⁵¹ Para. 3.42 above.

²⁵² Para. 3.16 above.

calculation.²⁵³ An accurate calculation of the cost of production, they contend, cannot be limited only to cash outlays because the Appellate Body spoke in terms of the investment of economic resources required in the production of goods and the amount a producer must recoup in order to avoid making losses.²⁵⁴ Thus, the Complainants assert a farmer would have to recoup the costs of family labour, return to management and equity, quota and costs for the marketing of milk in order to stay in business.²⁵⁵ It would be inconsistent, they submit, to consider that a farmer using family labour and management makes a profit to the extent that this labour is not remunerated.²⁵⁶ Further, the Complainants point out that equity financing represents just an alternative to debt financing that gives rise to costs.²⁵⁷ On the question of including quota, the Complainants argue that quota is an investment related to the production of milk and thus a cost, regardless of whether or not generally accepted accounting principles ("GAAP") require its amortization.²⁵⁸ As to marketing, transport and administrative costs, the Complainants maintain their exclusion would amount to drawing an artificial distinction between costs of production and costs associated with sale because there would not be any point in a farmer producing milk if that farmer could not afford to sell the milk.²⁵⁹

5.33 The CDC data, the Complainants point out, show an industry-wide average cost of production of CDN \$58.12 per hectolitre in 2001 and of CDN \$57.27 per hectolitre in 2000.²⁶⁰ In contrast, they assert, the average price for CEM was CDN \$29 in 2000 and continued to be close to that level in 2001.²⁶¹ Comparing these figures, they ask the Panel to conclude that sales of CEM are made well below the average total cost of production and that, hence, "payments" within the meaning of Article 9.1(c) are being made.²⁶²

5.34 Recalling the considerations set out in paragraphs 5.18-5.19 above, we *find* that the Complainants' case, as described in paragraphs 5.30-5.33 above, constitutes a *prima facie* showing that "payments" within the meaning of Article 9.1(c) are being made, such that Canada can reasonably attempt to discharge its burden under Article 10.3 of the *Agreement on Agriculture* of establishing why CEM sales do not involve "payments"

(b) Examination of Canada's case on the issue of "payments"

(i) *Canada's position on its implementation of the DSB's recommendations*

5.35 Canada claims that it has fully implemented the rulings and recommendations of the DSB following adoption of the panel and Appellate Body reports in the original case on *Canada – Dairy*.²⁶³ In this connection, Canada states that export transactions outside of Special Class 5(d) occur without government interference of any kind, and as such, do not benefit from export subsidies.²⁶⁴

²⁵³ Para. 3.29 above.

²⁵⁴ Paras. 3.11, 3.29 and 3.77 above citing Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 87.

²⁵⁵ Para. 3.32 above.

²⁵⁶ Paras. 3.32 and 3.34 above.

²⁵⁷ Paras. 3.26 and 3.34 above.

²⁵⁸ Paras. 3.42 – 3.43 and 3.46 above.

²⁵⁹ Para. 3.52 above.

²⁶⁰ Para. 3.53 above, based on Canadian Dairy Commission: Estimated Cost of Producing Milk.

²⁶¹ Para. 3.53 above.

²⁶² Paras. 3.54–3.55 and 3.75 above.

²⁶³ Para. 3.108 above.

²⁶⁴ *Ibid.*

(ii) *Canada's rejection of an industry-wide application of the benchmark*

5.36 The Panel notes that Canada disagrees with the Complainants' contention that the Appellate Body intended an industry-wide calculation of the average total cost of production as the relevant benchmark for determining the existence of payments, within the meaning of Article 9.1(c).²⁶⁵ In so arguing, Canada refers to the Appellate Body's statement that a payment is determined "by reference to a standard that focuses upon the motivations of the independent economic operator who is making the alleged 'payments' – here the producer – and not upon any government intervention in the marketplace."²⁶⁶ Canada asserts that the Appellate Body therefore intended that an appropriate calculation of the average total cost of production should be based on the average costs of individual producers and *not* the entire dairy industry.²⁶⁷ Additionally, Canada refers to the statement by the Appellate Body to the effect that "[t]he average total cost of production [should be determined] ... by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets."²⁶⁸ Rather than speaking here in terms of an industry-wide calculation of the average total production cost, Canada contends that the Appellate Body was merely indicating that both domestic and export production of the individual producer should be taken into account when calculating that average.²⁶⁹

5.37 Canada also draws the Panel's attention to the repeated usage of the singular form of terminology by the Appellate Body in connection with its description of the benchmark.²⁷⁰ These references, Canada maintains, are indicative of the Appellate Body's focus on the cost of production of the *individual* producer.²⁷¹ Moreover, Canada suggests the reference to "milk producers" cannot automatically be interpreted as meaning the "industry".²⁷²

5.38 Canada further argues against using an industry-wide average cost of production benchmark because the application of "a single industry-wide average would prevent efficient producers from being able to participate in legitimate commercial transactions without being deemed to confer a 'payment' merely because of the cost of production of higher cost producers."²⁷³ Canada argues that the application of an industry-wide average is particularly inappropriate because of the large variation of costs of production within the Canadian dairy industry.²⁷⁴

5.39 Moreover, Canada asserts that it would be very difficult for any government under an industry-wide application of the benchmark to monitor and notify its export subsidies, as costs of production within an industry may change from year to year.²⁷⁵

(iii) *Applicable benchmark in this case*

5.40 In view of the fact that the DSB has adopted the Appellate Body Report setting forth the "average total cost of production" as the relevant benchmark to determine the existence of "payments" under Article 9.1(c), and given that all Parties in this Second Recourse to Article 21.5 of the DSU are in

²⁶⁵ Paras. 3.59, 3.62-3.63 above.

²⁶⁶ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 92.

²⁶⁷ Para. 3.62 above.

²⁶⁸ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 96.

²⁶⁹ Para. 3.62 above.

²⁷⁰ Para. 3.63 above referring to statements by the Appellate Body Report in *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 81, 86, 87, 92, 94 and 96.

²⁷¹ Para. 3.63 above.

²⁷² Para. 3.62 above.

²⁷³ Canada's Response to Question No. 63.

²⁷⁴ Para. 3.59 above.

²⁷⁵ Canada's Comments on the Responses of New Zealand and the United States, para. 52.

agreement that this is the benchmark the Panel should apply²⁷⁶, none of them having endorsed the criticisms set forth in the European Communities' Third-Party Submission²⁷⁷, the Panel shall accordingly apply this newly enunciated benchmark in this case.

(iv) *Appellate Body's guidance on the nature of its newly enunciated benchmark*

5.41 In order to assess Canada's proposed interpretation of the Appellate Body's benchmark, the Panel considers it useful to first review the guidance provided by the Appellate Body on this issue.

5.42 The Panel notes in this connection the Appellate Body's statement that "it is significant that Article 9.1(c) of the *Agreement on Agriculture* does not expressly identify a standard or benchmark for determining whether a measure involves 'payments'."²⁷⁸ As general guidance, the Appellate Body said "that there are 'payments' under Article 9.1(c) when the price charged by the producer of the milk is less than the milk's *proper value* to the producer".²⁷⁹ But it went on to explain that "it is necessary to scrutinize carefully the facts and circumstances of a disputed measure, including the regulatory framework surrounding that measure, to determine the appropriate basis for comparison in assessing whether the measure involves 'payments' under Article 9.1(c)."²⁸⁰ Hence, the Panel understands that the standard proposed by the Appellate Body may need to change according to the particular factual and regulatory context.

5.43 In fashioning what it considered to be the appropriate benchmark, the Appellate Body emphasized that "the standard must be objective and based on the value of the milk to the producer."²⁸¹ It then posited that:

"for any economic operator, the production of goods ... involves an investment of economic resources, ... an investment in fixed assets ... and an outlay to meet variable costs These fixed and variable costs are the total amount which the producer must spend in order to produce the milk and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, possibly 'by virtue of governmental action'."²⁸²

5.44 In recognizing that Members' domestic subsidies may in some instances provide spillover benefits to exports, the Appellate Body considered that such a situation should not automatically be characterized as an export subsidy, but that domestic support should not be used without limit.²⁸³ The Appellate Body thus opined that an appropriate benchmark should respect the separation between the disciplines on domestic and export subsidies.²⁸⁴ It accordingly declared that the average total cost of

²⁷⁶ Paras. 3.9 and 3.12 above.

²⁷⁷ We recall that only the European Communities, as a Third Party, argues against the use of the Appellate Body's "average total cost of production" benchmark, noting that this benchmark has no legal foundation in the *Agreement on Agriculture*, that it inappropriately focuses on the provider, rather than the recipient, of a payment and that it is impractical to apply. The European Communities also observes that other WTO Members, including the United States, critiqued this benchmark in the DSB meeting at which the Appellate Body Report was adopted. (paras. 4.27 – 4.33)

²⁷⁸ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 76.

²⁷⁹ *Ibid.*, para. 73.

²⁸⁰ *Ibid.*, para. 76.

²⁸¹ *Ibid.*, para. 86.

²⁸² *Ibid.*, para. 87.

²⁸³ *Ibid.*, paras. 89-91.

²⁸⁴ *Ibid.*, paras. 91-92.

production is the appropriate benchmark for determining, in the circumstances of this case, whether there are "payments" within the meaning of Article 9.1(c).²⁸⁵

5.45 The Appellate Body also indicated that it favoured reliance on the average of *all fixed and variable costs* incurred in the production of a unit of milk, rather than on the *marginal (variable) costs* incurred in producing an additional unit of milk, noting that:

"[a]lthough a producer may very well decide to sell goods ... if the sales price covers its marginal costs, the producer will make losses on such sales unless all of the remaining costs associated with making these sales, essentially the fixed costs, are financed through some other source, such as through highly profitable sales of the product in another market. ... In the ordinary course of business, an economic operator chooses to invest, produce and sell, not only to recover the total cost of production, but also in the hope of making profits."²⁸⁶

5.46 With the above as background, the Appellate Body concluded that:

"in the circumstances of these proceedings, ... we believe that the average total cost of production represents the appropriate standard for determining whether sales of CEM involve 'payments' under Article 9.1(c) of the *Agreement on Agriculture*. The average total cost of production would be determined by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets."²⁸⁷

(v) *Panel's analysis of the nature of the benchmark*

5.47 The Panel notes that the Appellate Body did not specifically address whether this new benchmark – the average total cost of production of all milk – should be assessed as an industry-wide average or on some other basis more accurately reflecting the actual costs of individual producers and their participation in the CEM market. On the one hand, the Appellate Body's enunciation of the standard seems to be consistent with an industry-wide approach, where it speaks in terms of determining "[t]he average total cost of production ... by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both [domestic and export] markets."²⁸⁸ In a similar vein, the Appellate Body, in recalling the Article 21.5 panel's observation that there is a clear differential between the prices of CEM and the domestic market price, stated that "[t]his suggests the possibility that the prices of CEM might be below the average total cost of production and, thus, might involve 'payments' under Article 9.1(c)."²⁸⁹ On the other hand, the Appellate Body also made references to "[e]ach producer decid[ing] for itself whether, and when, to produce and sell milk as CEM"²⁹⁰ and to the need to focus on the choices and "motivations of the independent economic operator".²⁹¹

5.48 We note some additional textual support in the Appellate Body's analysis for the use of the industry-wide approach. Specifically, the Appellate Body considered that the cost of producing *all* milk should be divided by the *total number of units* of milk.²⁹² Had the Appellate Body wanted us to

²⁸⁵ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 88 and 92.

²⁸⁶ *Ibid.*, paras. 94-95.

²⁸⁷ *Ibid.*, para. 96.

²⁸⁸ *Ibid.*, para. 96.

²⁸⁹ *Ibid.*, para. 101.

²⁹⁰ *Ibid.*, para. 79.

²⁹¹ *Ibid.*, paras. 92 and 96.

²⁹² *Ibid.*, para. 96.

divide the cost of production of the individual producer by the total number of units of milk produced by that producer, it surely would have so instructed. The Appellate Body confirmed that it "adopted as a standard, for these proceedings, the average total cost of production of the milk *producers*".²⁹³ (emphasis added) This would suggest that the Appellate Body was not focusing on individual producer costs, as Canada contends.

5.49 In response to the Complainants' arguments, Canada proposes an interpretation of the Appellate Body's use of the phrase "costs of producing *all* milk" as merely referring to *all* the units of milk, whether produced for the domestic or export market, of each individual producer.²⁹⁴ Given the context in which the Appellate Body referred to "*all* milk", i.e., in setting forth the very method of calculating the average total cost of production, and the absence of express textual directive to that effect, the Panel is not persuaded by Canada's suggestion that we should imply that the Appellate Body intended a calculation for each *individual* producer.

5.50 In our understanding, the Appellate Body reference to "a standard that focuses upon the motivations of the independent economic operator who is making the alleged 'payments' – here the producer – and not upon any government intervention in the marketplace"²⁹⁵, was made in the context of its concern that automatically characterizing any governmental intervention in the form of domestic price support that benefits exports as an export subsidy would collapse the distinction in the *Agreement on Agriculture* between domestic and export disciplines.²⁹⁶ Accordingly, we have some doubts as to Canada's conclusion that the Appellate Body's benchmark should be each individual producer's average cost of production rather than an industry-wide average cost of production.

5.51 At this stage, the Panel is not persuaded that Canada is correct in its proffered interpretation of the benchmark enunciated by the Appellate Body. Nonetheless, in recalling that it is Canada's burden to establish that no payments are being made, we shall examine whether Canada, in relying on the costs to individual producers to determine the average total cost of production, provides a convincing defence that no payments are being made.

(vi) *Canada's critique of the Complainants' reliance on the CDC data and its arguments in favour of individual producer data*

5.52 The Panel notes that Canada, following on from its criticisms of the application of an industry-wide benchmark, proceeds to reject reliance on the CDC Guidelines and survey data as a valid basis for determining the average total cost of production.²⁹⁷ While not contesting the validity of the data collected by the CDC, Canada argues that this data is collected for a different purpose and does not provide relevant information for this case.²⁹⁸ Notably, Canada contends that the CDC Guidelines and the data collected in accordance with these Guidelines serve the economic and social objective of giving a fair return to efficient dairy producers, and that this is different from data on the actual costs of production.²⁹⁹

5.53 Because the CDC Guidelines and the data collected serve economic and social objectives, Canada maintains they do not provide a standard for assessing "payments" that is objective, as required by the Appellate Body.³⁰⁰ Further, because the Appellate Body stated that the relevant standard should

²⁹³ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 104.

²⁹⁴ Para. 3.62 above.

²⁹⁵ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 92.

²⁹⁶ *Ibid.*, paras. 88-92.

²⁹⁷ Para. 3.19 above.

²⁹⁸ Paras. 3.57 and 3.19 above.

²⁹⁹ Para. 3.19 above.

³⁰⁰ Paras. 3.80 – 3.81 above.

focus on the motivations of the independent economic operator and not any government intervention in the marketplace, it is inappropriate, in Canada's view, to rely on the CDC Guidelines, which are reflective of Canadian governmental policy towards the dairy industry.³⁰¹ Moreover, Canada asserts that in proposing reliance on the CDC survey data, the Complainants seek to reintroduce the domestic administered price as the relevant benchmark.³⁰² Canada notes that this benchmark was explicitly rejected by the Appellate Body.³⁰³

5.54 Canada also argues that the CDC survey data is an inappropriate basis for determining the average total cost of production in that it excludes the 30 per cent least efficient farmers, as well as those farmers with less than 60 per cent of the average production/output in each province.³⁰⁴ Canada has indicated that those small farms account for approximately 18 per cent of all milk production in Canada.³⁰⁵

5.55 However, Canada does not reject the cost of production survey data in its entirety.³⁰⁶ Rather, it proposes certain adjustments to the CDC calculations.³⁰⁷ First, Canada proposes including, in principle, the 30 per cent less efficient farms.³⁰⁸ To the eligible pool of more than 19,000 dairy farms in the nine provinces with farms participating in the CEM market, Canada applies a "statistically valid sampling method" to obtain a representative sample of 274 dairy farms whose costs of production are surveyed.³⁰⁹ The costs for each farm are computed on a per unit basis (dollars per hectolitre) and each farm is then ranked from lowest to highest according to its individual cost of production.³¹⁰ Then Canada divides the 274 farms by 10 to create 10 groupings (deciles) of producers.³¹¹ The individual farms are then weighted according to their production and an average weighted cost is calculated for each decile.³¹²

5.56 In order to provide information on the price of CEM contracts, Canada takes price and volume data from 785 CEM contracts, as reflected on the bulletin boards of Quebec, Ontario and Manitoba, and divides this number of contracts into deciles.³¹³ It then calculates an average CEM price, weighted according to volume, for each decile.³¹⁴ To calculate the weighted average return, Canada deducts transport, marketing and certain administrative fees from the price of CEM contracts.³¹⁵

5.57 Comparing the CEM returns of the 785 contracts with the cost of production of 274 dairy farms, Canada purports to show that more than three-quarters (about 77 per cent) of dairy producers can cover their average costs of production through CEM sales.³¹⁶ On the same basis, Canada does not contest the fact that approximately 23 per cent of dairy producers in the sample cannot cover their average costs of production in the CEM market.³¹⁷ Nonetheless, Canada argues it is reasonable to

³⁰¹ Paras. 3.13 and 3.19 above.

³⁰² Para. 3.41 above.

³⁰³ *Ibid.*

³⁰⁴ Paras. 3.19 – 3.20 and 3.23 above.

³⁰⁵ Footnote 72 above.

³⁰⁶ Para. 3.57 above.

³⁰⁷ Paras. 3.56 – 3.58 above and Canada's Exhibit CDA-8.

³⁰⁸ Para. 3.58 above and Canada's Exhibit CDA-8.

³⁰⁹ Para. 3.57 above and Canada's Exhibit CDA-8.

³¹⁰ Canada's Exhibit CDA-8.

³¹¹ Para. 3.57 above.

³¹² Canada's Exhibit CDA-8. While the Panel understands from CDA-8 that the cost of production within each decile is weighted according to output, we note Canada's Response to Question No. 39 to the effect that the cost of production within each decile is not weighted.

³¹³ Canada's Responses to Question Nos. 41-44.

³¹⁴ Canada's Exhibit CDA-11.

³¹⁵ Paras. 3.51 – 3.52 and 3.65 above. The Panel notes that Canada has also deducted these transport and administrative fees from the cost of production calculations.

³¹⁶ Para. 3.66 above.

³¹⁷ Paras 3.66 and 3.70 above.

assume that a rational producer would participate in the CEM market only if he or she could cover his or her production costs.³¹⁸ Therefore, Canada maintains, there is no reason to assume that the 23 per cent of producers who cannot cover their production costs would participate in this market.³¹⁹

(vii) *Panel's assessment of Canada's arguments and data on individual producers' costs*

5.58 We recall Canada's argument that an individual producer's average total cost of production should be the relevant yardstick for determining whether payments are being made.³²⁰ If Canada can convincingly show that the individual producers' costs of production allow the producers to participate in the CEM market without making losses, then, in our assessment, no payments are actually being made.

5.59 Looking at the data Canada adduces, we register concerns as to the objectivity of this evidence: while Canada includes the 30 per cent of producers excluded from the CDC survey data, it does not include cost data from the small farms with less than 60 per cent average output in each province.³²¹

5.60 We further note that, in the data presented by Canada, the unweighted cost of production of the individual producers, in Canada's sample, is as low as CDN \$7.01 and as high as CDN \$66.80³²², while the weighted average cost ranges from CDN \$18.53 to CDN \$46.60.³²³ At the same time, we note that the weighted CEM returns amongst the 785 contracts in the three provinces sampled, range from CDN \$24.15 to CDN \$33.61.³²⁴ We recall the statement by the Complainants, uncontested by Canada, that the simple average of CEM prices in 2000 was approximately CDN \$29.³²⁵

5.61 Thus, in comparing the non-weighted data on the individual producers' costs with the simple average CEM price, we observe that the average cost of production of some producers significantly exceeds the average CEM price. Further, if we are to accept Canada's argument that cost data and CEM returns should be weighted according to output³²⁶, a still significant proportion of producers clearly cannot cover their costs through CEM sales. We recall that Canada does not contest – in fact admits – that approximately 23 per cent of dairy producers in the sample cannot cover their average costs of production in the CEM market.³²⁷

5.62 We also note that, according to Canada's evidence, approximately 8,000 producers, or 40 per cent of all producers (in the nine provinces), have participated, at least on occasion, in the CEM market.³²⁸ Also according to Canada's evidence, CEM production represents approximately 3.6 per cent of all milk production in Canada.³²⁹ Canada has also indicated that participation in the CEM market is usually only short term and that only a minority of CEM producers (12.5 per cent) participate for more than one year.³³⁰ This may suggest that even if there are producers who can cover their

³¹⁸ Canada's Response to Question No. 4(a).

³¹⁹ *Ibid.*

³²⁰ See paras. 5.36-5.37 above.

³²¹ We recall our exposition of Canada's argument at para. 5.54 above as well as at para. 3.58 and footnote 72 above.

³²² Canada's Exhibit CDA-9; Canada's Response to Question No. 41.

³²³ Canada's Exhibit CDA-9.

³²⁴ Canada's Exhibit CDA-13.

³²⁵ Paras. 3.66 and 3.70 above.

³²⁶ Footnote 72 above.

³²⁷ Paras. 3.66 and 3.70 above.

³²⁸ Para. 3.70 above.

³²⁹ Footnote 85 above.

³³⁰ Para. 3.70 above and Canada's Exhibit CDA-15.

marginal costs in the CEM market, CEM sales are not viable for most producers who thus may only participate in the CEM market to the extent necessary to dispose of non-quota surplus milk.³³¹

5.63 Given that Canada accepts that 23 per cent of producers have production costs exceeding CEM returns, and recalling that Canada has invited us to focus on the costs of production of individual producers³³², we consider that Canada in essence asks us to extrapolate from its information that, in fact, no individual producer with costs exceeding CEM returns, sells milk into the CEM market. However, in asking the Panel to assume that only the more efficient producers participate in CEM sales, Canada, it would seem to us, is calling for an assumption that would obviate any examination pursuant to the Appellate Body's benchmark of whether sales below the average total cost of production are being made. We note, however, that the Appellate Body clearly did not exclude the possibility that a producer with total costs of production in excess of CEM returns, might make CEM sales, stating that "[t]o the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, possibly 'by virtue of governmental action'."³³³

5.64 Having carefully considered Canada's case for focusing on the individual producer in applying the cost of production benchmark, the Panel *finds* that Canada has neither sought to correlate its data on costs of production of individual producers with any information on participation in the CEM market, nor with that on the returns they might obtain in this market. While speaking of the costs to individual producers, not industry-wide average costs, Canada has only provided the Panel with average costs, albeit averages within ten groupings of producers. The Panel *finds*, moreover, that Canada has not presented any data - indeed, admits it has no data - on the basis of which the Panel could exclude that the 23 per cent of producers with costs of production in excess of the CEM price participate in the CEM market.

5.65 Accordingly, the Panel *finds* that Canada has not been able to demonstrate, pursuant to its proposed reliance on an individual average as the relevant total average cost of production benchmark, that no payments, within the meaning of Article 9.1(c), are being made.

5.66 We recall that at least one of Canada's rationales for having the Panel focus on the costs of individual producers rather than industry-wide averages is the wide variation in the cost-of-production efficiency of dairy farmers in Canada.³³⁴ In pursuit of this factual claim, Canada has presented evidence that merely confirms what Canada initially posited, i.e., that some farmers indeed have costs of production below CEM returns, while others do not. In our view, Canada's approach raises the two following additional problems.

5.67 First, we consider that Canada's proposed focus on the cost of production of individual producers would require a government to have access to, and make available, information on the cost of production of each producer and on whether or not the individual producer participates in the CEM market. It seems to us that only on rare occasion would a government have record-keeping of this magnitude. Quite apart from the administrative cost and unworkability of this approach, we note that even Canada has expressed doubts that the Appellate Body could have intended a benchmark for

³³¹ In this regard, we note that industrial milk production has exceeded Canadian requirements, defined as "domestic consumer demand and planned exports for industrial dairy products", both before and after the introduction of the CEM market. Canada's Exhibit CDA-27, reproducing CDC Annual Report 2000-2001, pages 13-14. We further note that as part of its claimed implementation of the recommendations in the original *Canada - Dairy* case, Canada asserts it has restricted its export subsidies to the quantity commitment levels for subsidized exports as set out in its Schedule. Para. 2.2 above.

³³² See paras. 5.36-5.37 above.

³³³ Appellate Body Report, *Canada - Dairy (Article 21.5 - New Zealand and US)*, para. 87.

³³⁴ Para. 3.59 above.

determining the existence of payments that entails a standard of proof akin to the "beyond a reasonable doubt" standard under criminal law.³³⁵

5.68 Second, the extensive amount of information required under Canada's proposed approach would make it very difficult for WTO Members to ensure that they are respecting their obligations under the *Agreement on Agriculture* in exercising their rights thereunder to grant domestic and export subsidies. In view of the unworkability of Canada's approach, such a Member whose exports also exceed its reduction commitment levels would have great difficulty in establishing that such exports have not benefited from export subsidies.

5.69 We recall that Canada has criticized the Complainants' proposed reliance on an industry-wide average for the cost of production benchmark, arguing that it would be very difficult for any government under an industry-wide application of the benchmark to monitor and notify its export subsidies, as costs of production within an industry may change from year to year.³³⁶ While this may indeed be the case, the Panel considers that monitoring and notification would be even more difficult under Canada's proposed application of the benchmark.

5.70 Nevertheless, we do see some merit in a number of the criticisms Canada expresses in relation to an industry-wide average of cost of production as the relevant benchmark. Specifically, we note Canada's argument that producers who can participate profitably in the CEM market may be deemed to confer payments if the industry-wide average cost of production exceeds CEM prices.³³⁷ In our view, in a market exhibiting great variation in production efficiency, the application of an industry-wide cost of production benchmark could result in producers being deemed to make payments even where not one producer with costs above the industry-wide average would be selling into the export market. In addition to not telling us much – if anything – about whether or not payments to dairy processors are in fact being made, it would be odd, in the Panel's view, if an interpretation of the *Agreement on Agriculture* should result in discouraging exports by efficient farmers, and yet this is what this industry-wide average cost of production benchmark would seem to entail.

5.71 Despite the merits of these critiques, however, the Panel rejects Canada's criticism that reliance on the CDC data would amount to reintroducing the regulated domestic price as the relevant benchmark.³³⁸ The Complainants' proposed reliance on the data collected pursuant to the CDC Guidelines is grounded in their argument, in which we concur, that this data represents a reasonably accurate and objective measure of costs of production of Canadian dairy producers. We agree with the Complainants that the fact that Canada uses this data to set the in-quota price in pursuit of social and economic objectives does not detract from the validity of the data because such objectives may become relevant in setting the in-quota price but not in calculating costs.

5.72 Moreover, we also disagree with Canada that we would in essence be reintroducing the domestic in-quota price as the relevant benchmark because it seems to us that a more accurate reflection of the average total cost of production of *all* of the Canadian dairy industry, i.e., one that also includes cost data from the 30 per cent least efficient farmers, as well as the small producers, would at any rate be substantially higher than the CDC cost figures and the domestic in-quota price.

³³⁵ Canada's Comments on the Responses of New Zealand and the United States, para. 56.

³³⁶ See para. 5.39 above.

³³⁷ We recall in this connection the exposition of Canada's argument at para. 5.38 above.

³³⁸ We recall, in this regard, that Canada does not contest the accuracy of the underlying CDC data.

5.73 In this connection, we take note of the CDC cost of production data, as provided by the Complainants, showing that the average cost of production of the Canadian dairy industry was CDN \$57.27 in 2000 and estimated to be CDN \$58.12 in 2001.³³⁹

5.74 The Panel notes that the Parties agree that the average CEM price in 2001 was approximately CDN \$31.50³⁴⁰ and in 2000 was approximately CDN \$29.³⁴¹ With the average cost of production, as reflected in the CDC survey data, exceeding the average CEM price by a factor of almost two, we consider that this constitutes a strong indication that, on average, payments are being made.³⁴²

(viii) *Canada's proposed exclusion of certain cost elements*

5.75 The parties, however, disagree as to the cost elements to be included in the calculation of the average total cost of production. Accordingly, it is necessary for us to examine whether Canada convincingly shows that certain elements for which the CDC Guidelines make allocation, should not be included in the calculation of average total cost of production in this case.

5.76 Canada argues that only actual costs, and not imputed costs, should be included in the cost calculation.³⁴³ It proposes an interpretation of the term "costs" as being limited to cash outlays.³⁴⁴ Canada therefore seeks to adjust the CDC survey data by excluding from such calculation the costs of family labour, return to management and return to equity.³⁴⁵ Canada also posits that the cost calculation should be limited to production costs only, to the exclusion of production quota, marketing, transport and certain administrative costs.³⁴⁶

5.77 In arguing that the cost calculation should also exclude profits³⁴⁷, Canada refers the Panel to a statement by the Appellate Body to the effect that "an economic operator chooses to invest, produce and sell, not only to recover the total cost of production, but also in the hope of making profits".³⁴⁸ According to Canada's view, the Appellate Body draws a clear distinction between costs to be recouped, on the one hand, and hoped for profits on the other.³⁴⁹ Canada in this context argues that family labour and return to equity are not costs to an enterprise but rather profits, and thus should not be included in calculating the cost of production.³⁵⁰

5.78 Canada also submits, in responding to the Complainants' proposed inclusion of the cost of quota, which we note is not accounted for under the CDC Guidelines, that quota should not be viewed as a restriction on production but rather as an entitlement to sell.³⁵¹ Canada further argues that the cost of quota is to be recouped in a different market, namely, the domestic market.³⁵² In support of its position, Canada points to GAAP that "do not require" the amortization of intangible assets with an

³³⁹ Para. 3.53 above.

³⁴⁰ Canada's Response to Question Nos. 61-62. New Zealand's Response to Question No. 62 and United States' Response to Question No. 62.

³⁴¹ Para. 3.53 above and Canada's Response to Question No. 62.

³⁴² The Panel notes that the data submitted by the various parties on costs of production and CEM prices are comparable with respect to the inclusion of transport, administrative and marketing fees. Canada's Exhibits CDA-11, CDA-12 and CDA-13; New Zealand's First Submission, para. 5.29; United States' First Submission, para. 29.

³⁴³ Paras. 3.37 – 3.38 above.

³⁴⁴ Para. 3.27 above.

³⁴⁵ Paras. 3.28 – 3.40 above.

³⁴⁶ Paras. 3.44 and 3.50-3.51 above.

³⁴⁷ Paras. 3.39 – 3.40 above.

³⁴⁸ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 95.

³⁴⁹ Paras. 3.39 – 3.40 above.

³⁵⁰ *Ibid.*

³⁵¹ Para. 3.44 above.

³⁵² *Ibid.*

indefinite useful life³⁵³, which, in Canada's view, includes production quota. According to Canada, only the impairment in the value of the quota in a given year, if any, as compared to that in a prior year, is to be included as a cost element.³⁵⁴

5.79 As for the exclusion of marketing, transport and certain administrative costs, Canada argues that these are costs arising in connection with *sales*, not production, which occur beyond the farm gate.³⁵⁵

(ix) *Panel's analysis of cost elements to be included/excluded*

5.80 The Panel, in examining which cost elements should be included, recalls the Appellate Body guidance that *all* fixed and variable costs should be included³⁵⁶, thus suggesting that there is no reason *a priori* to use only cash-based accounting methods. The Panel also takes note of the observation by the Appellate Body that the production of goods and services involves an investment of economic resources.³⁵⁷ We therefore consider that we must first determine the ordinary meaning of the words "cost" and "investment" in accordance with Article 3.2 of the *DSU* and Article 31 of the *Vienna Convention on the Law of Treaties* ("*Vienna Convention*"). The word "cost" is defined as an "[e]xpenditure of time or labour; what is borne, lost, or suffered in accomplishing or gaining something ...".³⁵⁸ The word "investment" is defined as "... investing of money (now also time or effort)...".³⁵⁹ Having thus examined the ordinary meaning of the words "costs" and "investment", we do not see any basis that would require us to exclude non-monetary costs *ab initio*.

5.81 Mindful of the argument of Canada, inviting us to have recourse to GAAP in interpreting the meaning to be given to the term "cost of production", we first note that the CDC Guidelines themselves state that they are based on GAAP.³⁶⁰ Second, we consider it useful to turn to the *Anti-Dumping Agreement* for contextual guidance, in line with Article 31 of the *Vienna Convention* and Article 3.2 of the *DSU*. Specifically, we turn to such contextual guidance to discern the relative weight to be given to GAAP in the proper calculation of costs of production. Article 2.2.1.1 of the *Anti-Dumping Agreement* tells us to calculate costs based upon "records kept by ... the producer, provided that such records are in accordance with *generally accepted accounting principles* of the exporting country and reasonably reflect the costs associated with the production and sale of the product ... [and] provided that such allocations have been *historically utilized* by ... the producer" (emphasis added)

5.82 Since Article 2.2.1.1 of the *Anti-Dumping Agreement* instructs that production costs are to be calculated using the allocations historically utilized so long as doing so is in accordance with GAAP, and since the CDC Guidelines purport to be in accordance with GAAP, we see no reason why family labour, return to management and return to equity should not be included in the definition of the cost of production in the present case.

5.83 In this context, the Panel notes the inconsistency between Canada's compensating producers for the elements of family labour, return to management and return to equity, in the domestic market, as borne out by the CDC Guidelines, while proposing to exclude these "*historically utilized*" allocations in applying the Appellate Body's cost of production benchmark. Similarly, we note the inconsistency of

³⁵³ Para. 3.44 above.

³⁵⁴ *Ibid.*

³⁵⁵ Paras. 3.50-3.51 above. Canada also proposes subtracting such costs to obtain the net CEM return.

³⁵⁶ See para. 5.45 above.

³⁵⁷ See para. 5.43 above.

³⁵⁸ *The New Shorter Oxford English Dictionary*, L. Brown (ed.) (Clarendon Press, 1993), Vol. I.

³⁵⁹ *Ibid.*

³⁶⁰ New Zealand's Exhibit NZ – 4 and United States' Exhibit US – 22 reproducing CDC Guidelines.

Canada's including marketing, transport and administrative expenses as costs when setting the domestic target price, while arguing for their exclusion in the calculation of the overall cost of production.

5.84 On whether or not to include the cost of obtaining quota in calculating the overall cost of production, we agree with the Complainants' explanation that this cost represents a real cost – even a cash outlay – that a producer will incur in the production of milk, regardless of which market the producer recoups that cost in. In our understanding, the GAAP, while possibly not requiring the amortization of quota, do not exclude such amortization. Since the Appellate Body, in referring to the total cost of production as including *all* fixed and variable costs, appears to have endorsed a broad interpretation of the term "cost", we doubt that quota should be excluded from such calculation.

5.85 Having examined what elements to include in the overall cost of production calculation, the Panel *finds* that Canada has not demonstrated why family labour, return to management, return to equity, quota and transport, marketing and administrative costs should not be included as costs of production and that, as a corollary, those deductions need to be made to the CDC survey data. In sum, we agree with the Complainants that the elements here mentioned are real costs to the producer who, if not able to recoup them, incurs losses and cannot stay in business over time. The Panel accordingly *finds* that the CDC data represent a sufficient, albeit conservative, approximation of the average total cost of production of the Canadian dairy industry. If anything, additions reflecting the cost of quota, not deductions, should be made to the cost elements reflected in the CDC survey data.

(c) Conclusion on the issue of "*payments*"

5.86 The Panel recalls its finding at paragraph 5.34 above that the Complainants have presented a *prima facie* case that payments are being made.

5.87 The Panel also recalls its finding at paragraphs 5.64-5.65 above that Canada's proposed approach focused on the costs of production of individual producers, but absent any data reflecting individual producers' costs, their participation or their returns in the CEM market, fails to demonstrate that no payments are being made, within the meaning of Article 9.1(c).

5.88 The Panel further recalls its finding at paragraph 5.85 above to the effect that Canada has not demonstrated why family labour, return to management, return to equity, quota and transport, marketing and administrative costs should not be included as costs of production.

5.89 In light of the Complainants *prima facie* case as to the existence of payments and Canada's failure to establish, pursuant to Article 10.3, that no payments are being made, the Panel *finds* that "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* are being made.

5.90 The Panel notes that we have made findings of the existence of "payments" based on both the Complainants' and Canada's interpretation of how to apply the Appellate Body's benchmark, thus making it unnecessary to decide *in this case* which of these two interpretations is the correct one.

3. Whether payments are "financed by virtue of governmental action"

(a) Basis for Panel's renewed examination of whether payments are "financed by virtue of governmental action"

5.91 The Panel notes that while the Appellate Body reversed the Panel's finding as to the appropriate benchmark for determining the existence of "payments" under the first element of Article 9.1(c), it neither made a finding as to whether or not payments exist in the current case nor any findings with

respect to the issue of "financ[ing] by virtue of governmental action".³⁶¹ Nevertheless, the Appellate Body, as *dicta*, provided certain indications as to the nature of the governmental action required and as to the causal link to the financing of payments.

5.92 Specifically, the Appellate Body opined that the presence of a "*demonstrable link*" between the governmental action and the financing of the payments is necessary to a showing that payments are financed "*by virtue of*" governmental action.³⁶² The Appellate Body equated this "*demonstrable link*" with a situation where there is a "*tighter nexus*" between the governmental action and the financing of payments than in a situation where there is a regulatory framework merely enabling a third person freely to make and finance payments.³⁶³

5.93 Thus, we deem it necessary to revisit, with the benefit of the Appellate Body's guidance, the issue of whether payments are "financed by virtue of governmental action".

5.94 At this stage, the Panel recalls its analysis in paragraphs 5.18-5.19 and 5.25 above as to the operational interpretation of Article 10.3. We shall therefore first examine whether the Complainants make a *prima facie* showing of a demonstrable link between governmental action and the financing of payments. Provided that the Complainants make such a *prima facie* case, it will then be for Canada to establish, pursuant to Article 10.3, that any payments are not "financed by virtue of governmental action" within the meaning of Article 9.1(c).

(b) Whether the Complainants make a *prima facie* case

5.95 The Complainants allege that, because a producer supplies CEM at a price which does not cover average production costs, i.e., makes a payment, and because the milk thus sold must be exported pursuant to government mandate, Canada's CEM market cannot be described as a deregulated one in which private individuals freely make and accept payments.³⁶⁴ Specifically, they argue that the prohibition on selling non-quota milk at the higher domestic in-quota price and on diverting CEM back into the domestic market, together with the exemption of the dairy processors from paying this higher price for CEM, constitute the governmental action by virtue of which payments are financed.³⁶⁵

5.96 The Complainants also argue that the Panel should focus its examination on the recipient of the subsidy (here, the processor), not on the provider thereof (the dairy producer).³⁶⁶ In this context, the Complainants observe that under the CEM scheme, it is ensured that whenever producers make a sale they will also be making a payment.³⁶⁷ Arguing that the issue of why producers choose to produce milk for the CEM market is irrelevant, the Complainants contend that what matters is that the choice of where to sell non-quota milk, once produced, is essentially a government-mandated choice.³⁶⁸ The only other "options", in their view, are to destroy the milk or to sell it in the much less attractive market for animal feed.³⁶⁹ Moreover, New Zealand points out, the cross-subsidization resulting from sales at the higher administered domestic price may make it rational for a producer to produce CEM.³⁷⁰

5.97 The Complainants assert that the exemption from the higher domestic regulated price is not necessary to Canada's supply management scheme because the Government need not enable processors

³⁶¹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 104; 105 and 118.

³⁶² *Ibid.*, para. 113.

³⁶³ *Ibid.*, para. 115

³⁶⁴ See paras. 3.94, 3.96 and 3.120 above.

³⁶⁵ Para. 3.96 above.

³⁶⁶ Para. 3.114 above.

³⁶⁷ Para. 3.120 above.

³⁶⁸ Paras. 3.117 – 3.119 and 3.121 above.

³⁶⁹ New Zealand's First Submission, para. 5.38, United States' First Submission, para. 44.

³⁷⁰ Para. 3.118 above.

to obtain milk below production cost.³⁷¹ Only the prohibition on diversion of non-quota milk back into the domestic regulated market, and not the exemption of processors from paying the higher domestic price, they argue, may be a significant element in Canada's price support scheme.³⁷² Canada's scheme, they argue, functions as a deliberate export subsidy, in the absence of which Canada would not be able to export dairy products.³⁷³

5.98 Recalling our statement in paragraph 5.94 above, the Panel *finds* that the Complainants' case, as described in paragraphs 5.95-5.97 above, provides a *prima facie* showing that payments are being "financed by virtue of governmental action", such that Canada can reasonably attempt to discharge its burden under Article 10.3 of demonstrating why CEM sales are not being financed by virtue of governmental action. We shall therefore turn to an examination of Canada's case on this issue.

(c) Examination of Canada's case on "financed by virtue of governmental action"

(i) *Canada's position regarding the lack of governmental involvement in the export market*

5.99 In recalling a statement of the Appellate Body, to the effect that the causal link would be more difficult to establish when a payment-in-kind is made by an independent economic operator, Canada argues that, on the facts of this case, the Appellate Body standard calls for a "particularly clear and convincing showing of the required linkage".³⁷⁴ Canada then argues that, in the context of the deregulated CEM market, the combination of the prohibition on selling non-quota milk on the domestic regulated market and the exemption of processors from paying the higher regulated domestic price is insufficient to meet the "rigorous standard" put forward by the Appellate Body.³⁷⁵ Specifically, Canada argues that the exemption of the processors from paying the higher domestic price does not ensure processors' access to milk for export at any particular price and that there is thus no tight nexus between the financing of payments and governmental action.³⁷⁶

5.100 Referring to the Appellate Body's distinction between a regulatory framework merely enabling a third person freely to make and accept payments and one for which a tight nexus between governmental action and financing of payments is present, Canada describes its "deregulated" export market as one in which private economic operators engage in transactions at arms length and on a purely commercial basis.³⁷⁷

5.101 Moreover, Canada maintains that the Complainants' argument to the effect that access to CEM without having to pay the domestic administered price equals financing, fails to give meaning to the word "financed".³⁷⁸ The mere fact that processors have access to CEM without paying the domestic administered price and that there are no limits placed on their ability to export is not *per se* WTO-inconsistent, according to Canada.³⁷⁹

5.102 Canada contends that the Government is not involved in the decision to sell non-quota milk as CEM milk because, "for Article 9.1(c) to apply there must be governmental action focussed or directed towards the financing of the alleged 'payment'".³⁸⁰ Canada then gives examples of what type of governmental action it considers would satisfy the test established by the Appellate Body, namely,

³⁷¹ Paras. 3.101 and 3.115 above.

³⁷² Paras. 3.107, 3.101 and 3.115 above.

³⁷³ Para. 3.107 above.

³⁷⁴ Para. 3.95 above.

³⁷⁵ *Ibid.*

³⁷⁶ Para. 3.116 above.

³⁷⁷ See paras. 3.97; 3.104; 3.108-3.109 and 3.113 above.

³⁷⁸ Para. 3.97 above.

³⁷⁹ Para. 3.116 above.

³⁸⁰ Para. 3.103 above.

setting prices, controlling volume or managing producer returns.³⁸¹ In addition, Canada asserts that if there was governmental action "obliging or driving" producers to produce CEM, the demonstrable link would be present.³⁸²

5.103 Canada also contends that to focus on the processor, as the Complainants argue, confuses the concept of "financed by virtue of governmental action" with the concept of "benefit".³⁸³ In its view, the issue is whether the alleged payments by independent producers are financed by virtue of governmental action.³⁸⁴

5.104 Canada maintains, in addition, that under the *Agreement on Agriculture*, WTO Members may provide domestic support to agricultural producers and that the prohibition on diversion of non-quota milk into the domestic market in Canada is necessary to protect the producers' entitlement to the higher domestic support price.³⁸⁵

5.105 In invoking the *SCM Agreement* and the case on *US – Export Restraints* as important contextual guidance, Canada argues that Article 9.1(c) of the *Agreement on Agriculture* should be construed in accordance with Article 1.1(a)(1) of the *SCM Agreement*, and specifically Article 1.1(a)(1)(iv), pursuant to which "a government *entrusts* or *directs* a private body to carry out ... functions ... which would normally be vested in government ... ", such as making direct transfers of funds, forgoing revenue or providing goods and services.³⁸⁶

(ii) *Appellate Body guidance on "financing by virtue of governmental action"*

5.106 Before embarking on a detailed examination of Canada's case regarding "financed by virtue of governmental action", we consider that we should first review the guidance by the Appellate Body on this subject. The Appellate Body observed that the text of Article 9.1(c) does not qualify the relevant types of governmental action, but includes governmental action "regulating the supply and price of milk in the domestic market".³⁸⁷ While stating that "mere governmental action" is not enough for there to be export subsidies, it opined that the presence of a "demonstrable link" between the governmental action and the financing of the payments means that payments are financed "by virtue of".³⁸⁸

5.107 The Appellate Body did not exclude that "payments may be financed by virtue of governmental action even though significant aspects of the financing might not involve government".³⁸⁹ At the same time, the Appellate Body was careful to distinguish a "regulatory framework merely enabling a third person freely to make and finance 'payments' [for which] ... the link between the governmental action and the financing of the payments is too tenuous" from a situation where there is "a tighter nexus between the mechanism or process by which the payments are *financed*, even if by a third person, and governmental action".³⁹⁰

5.108 Similarly, the Appellate Body distinguished a situation where a payment *occurs* as a consequence of governmental action from the situation where a payment is *financed* as a consequence

³⁸¹ Para. 3.103 above.

³⁸² *Ibid.*

³⁸³ Canada's Oral Statement, para. 56.

³⁸⁴ Canada's Executive Summary, para. 27.

³⁸⁵ At an early stage in the proceedings, Canada also argued that the exemption of the processors from paying the higher domestic price was also necessary to the domestic price support system. Canada's Submission, para. 66. However, Canada later admitted that this exemption was not necessary to this price support system. Para 3.116 above.

³⁸⁶ Paras. 3.147 - 3.148 above.

³⁸⁷ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 112.

³⁸⁸ *Ibid.*, para. 113.

³⁸⁹ *Ibid.*, para. 114.

³⁹⁰ *Ibid.*, para. 115.

of governmental action and for which a demonstrable link is thus present.³⁹¹ In the former situation, no such demonstrable link is present, according to the Appellate Body, "because the word 'financed', in Article 9.1(c), must also be given meaning".³⁹²

5.109 The Panel recalls that the Appellate Body noted that "[a]lthough the Panel addressed this issue in different ways, ... the Panel's reasoning, taken as a whole, was directed towards establishing the demonstrable link between governmental action and the financing of the payments."³⁹³ At the same time, however, the Appellate Body "disagree[d] with the Panel's characterization of the measure as 'obliging producers, at least *de facto*, to sell outside-quota milk for export'.³⁹⁴ The Appellate Body also noted that it did "not see how producers are obliged or driven to produce additional milk for export sale."³⁹⁵

(iii) *Panel's examination of "financed by virtue of governmental action" in light of the Appellate Body guidance*

5.110 The Panel recalls that in the first Article 21.5 compliance case, for the purpose of determining the link between governmental action and the financing of payments, that panel focused on the prohibition against selling non-quota milk at the domestic in-quota price and the anti-diversion measures, as a result of which CEM, by definition exempt from the domestic pricing regulations, was left as the only viable option to transact outside the regulatory framework of price floors and quota ceilings.³⁹⁶ In this earlier case, the panel spoke in terms of governmental action being "indispensable" to the financing of payments, in other words "establish[ing] the conditions which ensure that the payment takes place."³⁹⁷ The panel also there found that in order to meet the "by virtue of" test in Article 9.1(c), it would have to find that financing does not occur "but for" governmental action.³⁹⁸

5.111 In light of the fact that there has not been any change in the nature or the regulation of the Canadian dairy markets since the first Article 21.5 panel examined this matter, and in light of the Appellate Body's apparent support for the reasoning employed by the first Article 21.5 panel³⁹⁹, this Panel considers that it should initially focus on the same elements of governmental action as in the previous case, but applying a new test directed at determining whether governmental action is *demonstrably linked* to the financing of payments. In proceeding with our analysis, we are mindful of the distinction, rightly emphasized by the Appellate Body, between a situation where a payment is merely incidental to governmental action, and one where there is a tighter nexus between the governmental action and the effecting of a transfer of economic resources.⁴⁰⁰

5.112 The Panel recalls that under the previous supply management system, the Canadian government regulated price and marketing for all categories of milk.⁴⁰¹ Under Canada's implementation measures, the Canadian Government no longer negotiates or sets a price for its new category of export milk, called CEM, but still maintains a target price for domestic milk under quota, as well as for another new, domestic market category of milk, Class 4(m), used as animal feed.⁴⁰² Processors are exempt, by law,

³⁹¹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 113.

³⁹² *Ibid.*

³⁹³ *Ibid.*, para. 116.

³⁹⁴ *Ibid.*, para. 117.

³⁹⁵ *Ibid.*

³⁹⁶ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 6.77 and 6.78.

³⁹⁷ *Ibid.*, paras. 6.38, 6.40 and 6.44.

³⁹⁸ *Ibid.*, para. 6.41.

³⁹⁹ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 116.

⁴⁰⁰ We recall in this connection the statement in the Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115).

⁴⁰¹ Para. 2.1 above.

⁴⁰² *Ibid.*

from paying the higher in-quota price.⁴⁰³ Producers pre-commit to sell any quantity of non-quota milk as CEM and once pre-committed, such milk must be "first-out-of-the-tank", and may not be diverted back into the domestic market.⁴⁰⁴ Processors must account for the destination of all milk contracted as CEM milk and diversion into the domestic market is subject to financial and other penalties.⁴⁰⁵ As under the previous system, Canada places no restrictions on the quantity of milk that may be sold into the export market.⁴⁰⁶

5.113 In relation to Canada's argument that the prohibition on diversion is necessary to the protection of the producer's entitlement to the higher in-quota price, we have doubts that, even assuming a measure may be necessary to a particular supply management system of a WTO Member, such "necessity" can be equated with WTO consistency. Moreover, we have doubts that the exemption of processors from paying the higher domestic in-quota price for CEM, either on its own or together with the prohibition on diversion, is necessary to the protection of the producer's entitlement to that higher price. Indeed, Canada has admitted that this exemption is not necessary to protect the producer's entitlement.⁴⁰⁷

5.114 Looking at the implementation measures in dispute, the Panel notes that the parties have presented arguments on the nexus, or lack thereof, both from the perspective of the processor and from that of the producer. We will begin our examination by considering this matter from the perspective of the processor.

5.115 Looking from the perspective of the dairy *processor*, it is clear that the exemption of processors from paying the higher domestic in-quota price is demonstrably linked to exports of dairy products made with Canadian produced milk because if processors had to pay the in-quota price for CEM, exports of CEM would most likely dry up. As the record undisputedly confirms, the domestic regulated price is well above the world market price for milk.⁴⁰⁸ With milk being a principal ingredient of processed dairy products, Canadian processed dairy products using milk at the in-quota price could not be competitive on world markets. Indeed, we recall Canada's concurring statement to the effect that the exemption was adopted in order to allow for the functioning of a deregulated CEM market.⁴⁰⁹

5.116 Moreover, we consider that a rational, profit-maximizing processor, exempt by law from paying the in-quota price for CEM, will seek to transact for CEM at the lowest possible price. Because the processor has a legal right not to pay the in-quota price, ranging from approximately CDN \$50 to CDN \$56⁴¹⁰, a rational, profit-seeking processor, in our view, will be in a strong position to transact for CEM at a price below the domestic administered price, and thus, below the average total cost of production of Canadian dairy producers. Moreover, we consider that the unattractiveness of the other marketing option for non-quota milk, i.e., Class 4(m) milk, would put processors in a position to drive down the price of CEM still further. Finally, to the extent that milk sourced through IREP is substitutable and competitive with CEM, this would be yet another factor enabling processors to offer to

⁴⁰³ Paras. 3.99 and 3.116 above.

⁴⁰⁴ Para. 2.3 above.

⁴⁰⁵ Para. 2.2 above.

⁴⁰⁶ Para. 2.2 above.

⁴⁰⁷ Para. 3.116 above.

⁴⁰⁸ We recall that the domestic in-quota price in the previous proceedings was shown to range from CDN \$50 to CDN \$ 56. Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para 6.10.

⁴⁰⁹ Canada's Response to Question No. 14.

⁴¹⁰ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.10. In that report, New Zealand submitted that domestic market milk in the various classes sells for between CDN \$49.48 and CDN \$56.06 while the United States gave an average of CDN \$52.92 per hectolitre. Canada did not contest these figures.

transact for CEM at prices even below those for IREP-sourced milk. In this connection, we observe that the prices for CEM are on average lower than those for IREP-sourced milk.⁴¹¹

5.117 By virtue of the prohibition on diversion of CEM back into the domestic market, coupled with penalties, we consider that the Canadian government not only prevents the processor from seeking the highest return available for milk in the domestic market, but also ensures that the only option for a dairy processor producing a particular dairy product and wishing to sell beyond the amount manufactured through the supply of quota milk, is to produce for the export market.

5.118 Looking now from the perspective of the dairy *producer*, we note that the earlier Article 21.5 panel focused its inquiry primarily on the governmental action linked to the *sales* of CEM, not to the decision by the producer whether or not to *produce* milk for sale as CEM, and made findings only with respect to the link between governmental action and the decision to *sell*.⁴¹²

5.119 We recall in this connection that Canada stresses that there is no governmental action obliging or driving producers to produce milk for the CEM market, invoking a statement by the Appellate Body to the same effect.⁴¹³ We also recall the Complainants' argument that the reason for why producers decide to produce milk for the CEM market is irrelevant, given that the Government does not provide any real choice as to where producers may sell non-quota milk once produced.⁴¹⁴

5.120 From an economic perspective, it is clear to us that no meaningful distinction can be made between a producer's decision to *produce* non-quota milk and the decision where to *sell* that milk. These two decisions are in fact part and parcel of one integrated decision by any rational economic operator. Clearly, the decision to produce will be taken in light of the producer's costs and the sales options available, such that a producer will decide to produce only if in doing so that producer will be able to make profits or, at least, avoid making losses. In this sense, we agree with the Complainants that it may not be relevant to focus on the reasons why a producer may decide to produce. We consider that the question of whether governmental action "drives" producers to produce only becomes relevant where making sales would result in losses.

5.121 The Panel sees support for the above position in the Appellate Body's statement that governmental action can include "regulating the supply and price of milk in the domestic market"⁴¹⁵, and that "the existence of a demonstrable link [has to take account] of the particular governmental action ... and its effects on payments made by a third person".⁴¹⁶ In this sense, all that is required is that there be governmental action, such as that regulating the supply and price of milk in the domestic market, the effect of which is that producers make payments to dairy processors. Thus, if governmental action makes possible sales into the CEM market which would otherwise be made at a loss, i.e., not allowing for recovery of fixed and variable costs, we consider, in line with the Appellate Body's statement, that there would then be a demonstrable link between governmental action and the financing of payments.

5.122 In respect of the case before us, the record confirms Canada's regulation of both the domestic in-quota price and volume of milk, as well as the prices for Class 5(d) and Class 4(m) milk.⁴¹⁷ As we

⁴¹¹ We note that the price for IREP whole-milk powder is around CDN \$32.45 per hectolitre, whereas the unweighted CEM price is around CDN \$29 per hectolitre. cf. paras. 3.53, 3.54, 3.67, 3.74, 3.75 and footnotes 83 and 166 above.

⁴¹² Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 6.43-6.48 and 6.77.

⁴¹³ Para. 3.112 above.

⁴¹⁴ Paras. 3.121 – 3.122 above.

⁴¹⁵ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 112.

⁴¹⁶ *Ibid.*, para. 115.

⁴¹⁷ Para. 2.2 above.

understand it, the only sales option available to milk producers, not directly regulated by Canada, is that of the CEM market.

5.123 Due to the prohibition on selling non-quota milk at the in-quota price on the domestic market, the Canadian Government has foreclosed what would otherwise be the first-best option available to dairy producers, that of selling milk at the higher in-quota administered price. As a result of this prohibition, the only remaining options available are to produce and sell milk as CEM or as Class 4(m) animal feed, the latter yielding much lower returns. We note that the price of Class 4(m) animal feed is set by the Canadian Government at around CDN \$10 per hectolitre.⁴¹⁸

5.124 In our view, given the rational, profit-seeking motivations of private economic operators, and the regulation of the price for Class 4(m) by Canada, the Canadian Government ensures that the bulk of non-quota milk will be channelled into the CEM market; only a small fraction of non-quota milk – that which has not previously been pre-committed – will likely be sold as Class 4(m) animal feed.

5.125 In our assessment, the rational, profit-maximizing milk producer, in deciding whether to participate in the CEM market, will take into account the extent to which the income derived from selling milk at the in-quota price allows that producer to sell into the CEM market while at least recovering his or her marginal costs for that additional production. To the extent that the governmental support price for in-quota milk enables producers to cover their fixed and variable costs through production for sales at the in-quota price and make additional sales into the CEM market at marginal cost, we consider that a strong nexus exists.

5.126 With reference to the case before us, we recall Canada's acknowledgement that, pursuant to its proposed method for calculating average total cost of production, approximately 23 per cent of milk producers would be unable to cover their fixed and variable costs in the CEM market.⁴¹⁹ We further recall that, in this connection, Canada's proposed method would exclude imputed costs of family labour, return to management, return to equity and production quota, as well as transport, marketing and administrative costs.⁴²⁰ Nevertheless, we also recall that, in our view, all these costs are properly to be included in a calculation of the average total cost of production.⁴²¹

5.127 If account is taken of these costs, it appears that, absent governmental support through the in-quota price, the percentage of Canadian dairy producers who would be unable to cover their fixed and variable costs through sales into the CEM market would be much higher than the 23 per cent posited by Canada. Indeed, as recalculated by New Zealand, and absent the Canadian support price for in-quota milk, fully 100 per cent of Canadian dairy producers would not be able to cover their fixed and variable

⁴¹⁸ Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.52.

⁴¹⁹ Paras. 3.66 and 3.70 above.

⁴²⁰ See para. 5.76 above.

⁴²¹ See para. 5.85 above.

costs in the CEM market.⁴²² Thus, in the circumstances of this case, the Panel considers that governmental action in the form of regulating the supply and price of in-quota milk produces significant effects on payments made by third persons, in that this governmental action cross-subsidizes many sales that otherwise would not be made or would at least constitute sales at a loss.

5.128 In addition, we recall that the support price for in-quota milk is set in accordance with the CDC Guidelines at a level that rewards only the 70 per cent more efficient dairy farmers.⁴²³ The Panel notes that other sources of information from the Canadian news media, put forward by the Complainants, suggest that a substantially smaller percentage, between 25 and 39 per cent, of dairy farmers cover their costs under the in-quota price set in accordance with the CDC Guidelines.⁴²⁴ In these circumstances, the Panel considers it likely that for a significant percentage of Canadian dairy farmers who are just barely able to cover both their fixed and variable production costs through in-quota domestic sales, the level of the in-quota price creates a strong inducement – to the extent these farmers can cover their marginal costs – to produce additional milk for sale into the CEM market.

5.129 Even though we consider that the governmental action of regulating the supply and price of milk in the domestic market produces effects on and is demonstrably linked to the financing of payments by producers, our analysis here should not be read to suggest that Article 9.1(c) requires that the governmental action *directly* finance payments made by independent economic operators. On the contrary, the Panel considers that the ordinary meaning of Article 9.1(c), and in particular the phrase "... whether or not a charge on the public account is involved ...", makes clear that governmental action need not directly finance payments. This reading has been expressly endorsed by the Appellate Body.⁴²⁵

5.130 In addition to the impact of cross-subsidization on the financing of payments by third parties, we also consider that the regulatory policy of "pre-commitment" may also have a similar impact. In our view, a rational, profit-maximizing producer who has purchased an entitlement to sell at the high in-quota price will clearly want to fill the amount of quota he or she holds and will therefore be likely to err on the side of slight overproduction⁴²⁶, thus ensuring full use of the entitlement. The rational

⁴²² New Zealand's Response to Question No. 33

A. Deciles of costs of production	B. Estimated imputed and marketing costs	C. Total costs of production	Percentage of producers	Cumulative percentage of producers
From CDA-9 CDN \$ /hl	NZ rebuttal submission footnote 59 CDN \$ /hl	C.=A.+B. CDN \$ /hl	%	%
41.55-66.80	26	67.55-92.80	10	100
37.77-41.41	26	63.77-67.41	10	90
35.32-37.43	26	61.32-63.43	10	80
33.36-35.25	26	59.36-61.25	10	70
31.74-33.35	26	57.74-59.35	10	60
29.40-31.72	26	55.40-57.72	10	50
27.05-29.33	26	53.05-55.33	10	40
24.84-26.96	26	50.84-52.96	10	30
22.37-24.71	26	48.37-50.71	10	20
7.01-22.07	26	33.01-48.07	10	10

⁴²³ Para. 3.23 above.

⁴²⁴ New Zealand's Exhibit NZ-7, citing press releases from the Dairy Farmers of Canada Board of Directors and the Dairy Farmers of Ontario; United States' Response to Question No. 33, citing US Exhibit 22 from the first Article 21.5 proceeding.

⁴²⁵ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115; Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 108.

⁴²⁶ See footnote 85.

producer in these circumstances will opt for pre-committing milk production as CEM rather than face having to dispose of the milk as Class 4(m) animal feed.⁴²⁷ Because of the relative unattractiveness of the price for Class 4(m) milk and because a producer cannot channel any non-quota milk that has not been pre-committed into the CEM market, the Panel considers that the policy of pre-commitment, in those provinces where it is required by law⁴²⁸, provides an additional incentive to pre-commit a larger quantity of milk than the producer would market as CEM if able to allocate to that market *ex post*.

(iv) *The SCM Agreement as contextual guidance for Article 9.1 of the Agreement on Agriculture*

5.131 We recall Canada's argument that the concept of export subsidies found in Article 9.1 should be interpreted with reference to Article 1.1(a)(1), and particularly Article 1.1(a)(1)(iv), of the *SCM Agreement* as context.⁴²⁹ On this point, the Complainants argue that Canada is improperly seeking to narrow the scope of the *Agreement on Agriculture*.⁴³⁰ Specifically, they assert that the concept of "financial contribution" in Article 1.1(a)(1) of the *SCM Agreement* has no relevance to Article 9.1(c) of the *Agreement on Agriculture* which is concerned with "payments".⁴³¹ Similarly, they state, the words "entrust[ing] or direct[ing]" in Article 1.1(a)(1)(iv) of the *SCM Agreement* has no bearing on the interpretation of Article 9.1(c) of the *Agreement on Agriculture*.⁴³²

5.132 In the present case, because we consider that there is a demonstrable link between governmental action and the financing of payments within the meaning of Article 9.1(c) of the *Agreement on Agriculture*, we do not see any need to consider whether Article 1.1(a)(1) or Article 1.1(a)(1)(iv) of the *SCM Agreement* may provide relevant context. In addition, we again take note of the Appellate Body's statement that "payment" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* may include a payment made by third parties.⁴³³ In this sense, we agree with the Complainants' arguments that Article 1.1(a)(1) of the *SCM Agreement* has a narrower meaning than Article 9.1(c) of the *Agreement on Agriculture* as interpreted by the Appellate Body. For this same reason, we see no justification for looking to the specific example of "financial contribution by a government" found in Article 1.1(a)(1)(iv), invoked by Canada. Again, "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture* may be made by third parties. Moreover, no Party has ever suggested that the notion of government entrusting or directing private bodies to make financial contributions normally made by a government, within the meaning of Article 1.1(a)(1), has any relevance to this case.

(d) Conclusion as to whether payments are "financed by virtue of governmental action"

5.133 The Panel recalls its finding in paragraph 5.98 above that the Complainants make a *prima facie* case of a demonstrable link between governmental action and the financing of payments.

5.134 In light of our analysis above, the Panel *finds* that Canada, pursuant to Article 10.3, has failed to establish that governmental action – in the form of the exemption of CEM processors from paying the

⁴²⁷ The Panel recognizes that producers who have pre-committed milk as CEM, but who are unable to meet their pre-commitment obligation, may be penalized through the operation of the governmental "first-out-of-the-tank" policy whereby the government reallocates milk produced under quota to make up for any shortfall in CEM pre-commitments. Canada's Exhibit CDA-13D in Panel Report, *Canada – Dairy, (Article 21.5 – New Zealand and US)*. However, in our view, this policy does not remove the producer incentives to pre-commit.

⁴²⁸ Para. 3.65 above, citing Canada's Exhibit CDA-10. We note that the three provinces concerned, Ontario, Quebec and Manitoba, account for the bulk of all Canadian milk production, i.e., approximately 80 per cent.

⁴²⁹ See para. 5.78 above.

⁴³⁰ Para. 3.86 above.

⁴³¹ Para 3.88 above.

⁴³² *Ibid.*

⁴³³ Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 113; Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 96 and 115.

higher in-quota price, the prohibition on the diversion of CEM back into the domestic regulated market, the cross-subsidization provided through the in-quota price and the mandated pre-commitment policy – is not demonstrably linked to the financing of payments.

5.135 The Panel therefore *finds* that payments are "financed by virtue of governmental action" within the meaning of Article 9.1(c).

4. Conclusion on Article 9.1(c) of the Agreement on Agriculture

5.136 Having found in paragraph 5.89 above that "payments" are being made, and in paragraph 5.135 above that payments are "financed by virtue of governmental action", and because the Parties have not contested the finding of the first Article 21.5 panel that any payments are made "on the export" of processed dairy products, the Panel *finds* that Canada provides export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

E. ARTICLE 3.3 OF THE AGREEMENT ON AGRICULTURE

5.137 Having found that CEM exports are being subsidized within the meaning of Article 9.1(c), the Panel recalls the original panel's⁴³⁴ and the Appellate Body's⁴³⁵ findings that, as acknowledged by Canada⁴³⁶, Class 5(d) exports are also subsidized within the meaning of Article 9.1(c). Since it is uncontested that Canada's exports of cheese and "other milk products" exceed Canada's export subsidy reduction commitment levels, the Panel *finds* that Canada has provided export subsidies in respect of cheese and "other milk products" in excess of its quantity commitment levels specified in its Schedule, and is therefore in breach of Article 3.3 of the *Agreement on Agriculture*.

F. WHETHER EXPORT SUBSIDIES EXIST WITHIN THE MEANING OF ARTICLE 10.1 OF THE AGREEMENT ON AGRICULTURE

1. Introduction

5.138 In the alternative to their claims under Article 9.1(c), the Complainants have made claims under Article 10.1 of the *Agreement on Agriculture*. Canada claims that it does not provide export subsidies within the meaning of Article 10.1.

5.139 Article 10.1 provides as follows:

"Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments."

5.140 The Panel recalls that the original panel in *Canada – Dairy*, in its finding under that Article, considered that the elements of an Article 10.1 subsidy are whether there are: (1) export subsidies not listed in paragraph 1 of Article 9; and whether any such export subsidies are (2) applied in a manner resulting in or threatening to lead to circumvention of export subsidy commitments.⁴³⁷ We note that, as

⁴³⁴ Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.113.

⁴³⁵ Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para. 124.

⁴³⁶ Para. 2.2 above; Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 8.1 and Appellate Body Report, *Canada – Dairy*, DSR 1999:V, 2057, para 144.

⁴³⁷ We note that the panel did not address the second phrase of Article 10.1 and considered that the first sentence comprised two elements. Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, paras. 7.118 and 7.120. We recall that the Appellate Body, in discerning the meaning of "to circumvent", noted the dictionary definition of the term as meaning "to find a way round, evade ...". Appellate Body Report, *US – FSC*, para. 148.

the Appellate Body has stated, because Article 10.1 is residual in character to Article 9.1, a measure listed as an export subsidy in Article 9.1 cannot simultaneously be an export subsidy under Article 10.1.⁴³⁸ We also recall that, as the original panel in *Canada – Dairy* stated, "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 basic requirement of Article 1(e) that they are 'subsidies contingent upon export performance'."⁴³⁹

5.141 We have earlier examined whether or not there is an export subsidy within the meaning of Article 9.1(c), and found that an export subsidy within the meaning of Article 9.1(c) exists. However, should our finding under Article 9.1(c) be reversed on appeal, this would mean that at least one of the definitional elements of this provision would not be present. Accordingly, in order to resolve the matter in dispute, we consider it advisable to proceed to examine the Parties' claims and arguments under Article 10.1.

5.142 In recalling our consideration on the operational interpretation of Article 10.3 in paragraphs 5.18-5.19 above and in accordance with our analysis under Article 9.1(c), the Panel will first determine whether the Complainants make a *prima facie* case that certain elements of the Canadian regulation of its dairy industry constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*. Provided we find that the Complainants make a *prima facie* case that export subsidies within the meaning of Article 10.1 exist, it will then be for Canada to attempt to discharge its burden, pursuant to Article 10.3, of establishing that no such export subsidies exist. Similarly, assuming the Panel finds that the Complainants provide a *prima facie* showing that the manner of application of such export subsidies results in or threatens to result in circumvention of export subsidy commitments, it will be for Canada, pursuant to Article 10.3, to establish that the manner of application does not result in or threaten to lead to circumvention of these commitments. In the same vein, should the Panel find that the Complainants make out a *prima facie* case that non-commercial transactions are being used by Canada to circumvent its export subsidy reduction commitment levels, it will then be for Canada to establish the contrary.

2. Whether "export subsidies" exist

5.143 The first issue to be addressed under Article 10.1 is whether or not one or more of the definitional elements of an Article 9.1 subsidy is absent. Here, since the Complainants have only alleged one specific type of Article 9 export subsidy, that found under Article 9.1(c), we need only exclude the simultaneous applicability of Article 9.1(c) and Article 10.1, and not that of the other subparagraphs of Article 9.1 setting forth other types of export subsidies.⁴⁴⁰ Although we have found all definitional elements of an Article 9.1(c) export subsidy to be present, we shall assume for the purpose of our analysis under Article 10.1 that one or more of the definitional elements of an Article 9.1(c) export subsidy is not present.

(a) Whether the Complainants make a *prima facie* case

5.144 The Complainants argue that the *SCM Agreement* and especially paragraph (d) of the *Illustrative List of Export Subsidies* in Annex I⁴⁴¹, as well as Article 1.1(a)(2) of the *SCM Agreement*⁴⁴², provide useful interpretative guidance under Article 10.1 of the *Agreement on Agriculture* on whether

⁴³⁸ Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 121.

⁴³⁹ Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.125.

⁴⁴⁰ Even if it could be argued that the Panel, on its own initiative and despite the lack of any argumentation on the issue, would need to exclude all types of export subsidies listed in Article 9.1, a cursory review of that provision suggests to us that all those types listed involve direct forms of subsidies.

⁴⁴¹ Para. 3.131 above.

⁴⁴² Para. 3.153 above.

subsidies contingent on export performance exist. The United States argues that because the question in this dispute is one of export subsidies, it is more appropriate, as stated by the panel in the original *Canada – Dairy* case, "to examine what practices are considered under the *SCM Agreement* to be 'export subsidies', rather than to examine how that agreement defines the more general concept of a 'subsidy' in its Article 1."⁴⁴³

5.145 The Complainants state that the CEM scheme fulfils the elements of paragraph (d) of the *Illustrative List* because: (1) the goods are provided on terms more favourable than those for like goods for domestic consumption, since CEM prices are lower than those for domestic milk⁴⁴⁴; (2) the provision of goods is made or mandated by governments for export as a result of the governmentally created and enforced prohibition on sale in the domestic market and because the lower prices are available only for export⁴⁴⁵; (3) the goods are available on terms more favourable than those commercially available on world export markets because of the relative unattractiveness of IREP, i.e., the in-quota tariff, the discretionary issuance of the permit and payment of the permit fee, in comparison to CEM, and the processor's choice thus does not depend on commercial considerations.⁴⁴⁶

5.146 The United States also argues that IREP whole-milk powder is not fully substitutable with fluid milk and that additional costs arise in connection with rehydration.⁴⁴⁷

5.147 The Complainants further contend that Article 1.1(a)(2) of the *SCM Agreement* provides relevant context to the interpretation of "export subsidy" in Article 10.1 of the *Agreement on Agriculture*.⁴⁴⁸ They allege that the CEM system is one providing "income or price support ... which operates directly or indirectly to increase exports" because the government has created a system which makes milk available to processors for export at below both its domestic price and its average total cost of production.⁴⁴⁹

5.148 Recalling our statement in paragraph 5.142 above, the Panel *finds* that the Complainants' case, as described in paragraphs 5.144-5.147 above, provides a *prima facie* showing that export subsidies within the meaning of Article 10.1 exist, such that Canada can reasonably attempt to discharge its burden, under Article 10.3 of the *Agreement on Agriculture*, of establishing that no export subsidies exist.

(b) Canada's case on whether "export subsidies" exist

5.149 Canada argues that because there is an issue as to the meaning of "indirectly through government-mandated schemes", as set forth in paragraph (d) of Annex I of the *SCM Agreement*, it is necessary to have recourse to the general definition of "subsidy" set out in Article 1.1 of the *SCM Agreement*.⁴⁵⁰ In this context, Canada specifically references the definition provided in Article 1.1(a)(1)(iv), according to which a government "entrusts or directs a private body" to provide goods through delegation or an authoritative instruction or command.⁴⁵¹ Canada maintains that the government has not instructed individual producers to provide CEM to processors but rather that they enter into commercial transactions on their own volition.⁴⁵²

⁴⁴³ Para. 3.146 above.

⁴⁴⁴ Para. 3.132 above.

⁴⁴⁵ Para. 3.133 above.

⁴⁴⁶ Paras. 3.134 - 3.135 above.

⁴⁴⁷ Para. 3.144 above.

⁴⁴⁸ Para 3.153 above.

⁴⁴⁹ *Ibid.*

⁴⁵⁰ Para. 3.147 above.

⁴⁵¹ Para. 3.148 above.

⁴⁵² *Ibid.*

5.150 Moreover, Canada contends that Canada's regulation of its dairy industry does not meet the definitional requirements of paragraph (d) of the *Illustrative List*.⁴⁵³ In this connection, Canada asserts that the meaning of "indirect" in paragraph (d) should be interpreted consistently with the meaning of that term as it appears in Article 1.1 of the *SCM Agreement*.⁴⁵⁴ Specifically, Canada maintains that there is no provision of products through a government mandated scheme because the government does not command or direct producers to produce CEM.⁴⁵⁵ Canada also disputes that the prices under IREP are less favourable than prices for CEM because, in its view, the Appellate Body has already rejected that the existence of administrative formalities mean that imports are available on terms and conditions that are less favourable.⁴⁵⁶ Tariffs, in Canada's view, fall into the same category as administrative formalities.⁴⁵⁷ Finally, Canada submits that there is no independent requirement that a subsidy illustrated in paragraph (d) be shown to be contingent on export performance because "every subsidy illustrated in Annex I of the *SCM Agreement* is by definition an Article 1.1 'subsidy' that is contingent on export performance".⁴⁵⁸

5.151 In reference to Article 1.1(a)(2), Canada asserts that to conclude that because Canada does not prevent sales of CEM from occurring at prices mutually agreed to between buyer and seller Canada is thereby "supporting" the income generated by these sales is inconsistent with the concept of "support".⁴⁵⁹

(c) Panel's examination of whether "export subsidies" exist

5.152 On the issue of how to give definition to the term "export subsidies" in Article 10.1, the Panel recalls that the Parties disagree as to whether reference to the *Illustrative List* found in Annex I of the *SCM Agreement* should be made in this case for contextual guidance.⁴⁶⁰

5.153 We note that Article 1(e) of the *Agreement on Agriculture* defines "export subsidies" as "subsidies contingent upon export performance", which is essentially identical to the definition of prohibited export subsidies found in Article 3.1(a) of the *SCM Agreement*. Moreover, Article 3.1(a) includes within the concept of "subsidies contingent upon export performance", those subsidies illustrated in Annex I. Accordingly, and in line with the approach adopted by the original panel on *Canada – Dairy*, we consider it appropriate to turn first to Article 3.1(a) of the *SCM Agreement* and the *Illustrative List* in Annex I to that Agreement as contextual guidance for the term "export subsidies" as contained in Article 10.1 of the *Agreement on Agriculture*.

5.154 WTO jurisprudence confirms that all of the practices identified in the *Illustrative List* of the *SCM Agreement* are subsidies contingent upon export performance, within the meaning of Article 3.1(a).⁴⁶¹ We note that the panel in *Brazil – Aircraft (Article 21.5 (I))* analogized the *Illustrative List* to a list of *per se* violations.⁴⁶² This reasoning was implicitly endorsed by the Appellate Body in reviewing that panel's decision.⁴⁶³ We therefore consider that we need not first turn to Article 1.1(a)(1), and particularly not Article 1.1(a)(1)(iv). In this connection, we note that in the first Article 21.5 compliance case in *Brazil – Aircraft*, Canada actually argued to the panel that the *Illustrative List*

⁴⁵³ Para. 3.139 above.

⁴⁵⁴ Para. 3.137 above.

⁴⁵⁵ Paras. 3.139 and 3.142 above.

⁴⁵⁶ Canada's Executive Summary, para. 41.

⁴⁵⁷ Canada's Executive Summary, para. 42.

⁴⁵⁸ Para. 3.137 above.

⁴⁵⁹ Para. 3.162 above.

⁴⁶⁰ See paras. 5.144 and 5.149 above.

⁴⁶¹ Panel Report, *Canada – Autos*, para. 10.197; Panel Report, *Brazil – Aircraft (Article 21.5 (I))*, para. 6.42.

⁴⁶² Panel Report, *Brazil – Aircraft (Article 21.5 (I))*, para. 6.42.

⁴⁶³ Appellate Body Report, *Brazil – Aircraft (Article 21.5 (I))*, para. 61.

should be considered a *per se* list of prohibited export subsidies.⁴⁶⁴ Neither do we think it necessary to have recourse to Article 1.1(a)(2), which the Complainants suggest also provides interpretative guidance for the meaning of "export subsidies" within the meaning of Article 10.1 of the *Agreement on Agriculture*.

5.155 We shall accordingly examine the Parties' claims in relation to paragraph (d) of the *Illustrative List*, as interpretative guidance, to determine whether Canada provides a valid defence to the claim that export subsidies, within the meaning of Article 10.1 of the *Agreement on Agriculture*, exist.

5.156 Paragraph (d) of the *Illustrative List* provides in relevant part as follows:

"The provision by governments or their agencies either directly or indirectly through government-mandated schemes, of imported or domestic products ... for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products ... for use in the production of goods for domestic consumption, if ... such terms or conditions are more favourable than those commercially available⁵⁷ on world markets to their exporters.

⁵⁷ (*footnote original*) The term 'commercially available' means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations".

5.157 We understand that, as stated by the original panel in *Canada - Dairy*⁴⁶⁵, paragraph (d) requires the presence of three elements: (1) the provision of products for use in export production on terms more favourable than for provision of like products for use in domestic production; (2) by governments either directly or indirectly through government mandated schemes; and (3) on terms more favourable than those commercially available on world markets.

5.158 As for the first element, the Panel notes it is uncontested that CEM prices are lower than the in-quota price of milk on the domestic market. As Canada considers it unnecessary to contest this first element⁴⁶⁶, the Panel need not examine this issue further.

5.159 With respect to the second element, the Panel recalls Canada's contention that the regulation of its dairy industry does not meet some of the definitional requirements of paragraph (d) of the *Illustrative List*.⁴⁶⁷ First, we note that Canada asks us to interpret the meaning of "indirect" in paragraph (d) in accordance with the meaning of that term as it appears in Article 1.1 of the *SCM Agreement* and, accordingly, to find that there is no provision of products through a government mandated scheme because the government does not command or direct producers to produce CEM.⁴⁶⁸ We also note the Complainants' response to the effect that the provision of goods is made or mandated by government for export as a result of the governmentally created and enforced prohibition on diversion of CEM into the domestic regulated market and because the lower prices for CEM are available only for export.⁴⁶⁹

5.160 On the interpretation of the term "indirect", we do not consider Canada's proposed reference to the terms "entrust[ing] or direct[ing] a private body ...", as contained in Article 1.1(a)(1)(iv), to be relevant to the type of governmental involvement at issue in this case. Moreover, we recall our analysis under Article 9.1(c) of the *Agreement on Agriculture*, in which we found a demonstrable link between payments and the financing by virtue of governmental action without such a degree of directness as that

⁴⁶⁴ Panel Report, *Brazil – Aircraft (Article 21.5 (I))*, Annex 1-2: Canada's Rebuttal Submission, para. 26.

⁴⁶⁵ Panel Report, *Canada – Dairy*, DSR 1999:VI, 2097, para. 7.128.

⁴⁶⁶ Canada's First Submission, para. 102.

⁴⁶⁷ See para. 5.150 above.

⁴⁶⁸ *Ibid.*

⁴⁶⁹ See para. 5.145 above.

being called for by Canada under Article 10.1.⁴⁷⁰ We observe that given the residual character of Article 10.1, which comes into operation only if one of the elements of an Article 9.1 export subsidy is not present, for us to rely on Canada's proposed interpretation would unduly narrow Article 10.1, thus depriving it of meaning. Rather, as the Complainants argue, we consider that the provision of goods is made or mandated by government for export as a result of the prohibition on diversion of CEM back into the domestic regulated market and the exemption which gives processors for export access to the lower CEM prices.

5.161 As for the third element, we recall our earlier observation that IREP prices are on average higher than CEM prices.⁴⁷¹ Based on the arguments and evidence before this Panel, we consider that the combination of the discretionary nature of the IREP permit, the permit fee itself, the in-quota tariff on IREP milk, the formalities associated with obtaining duty drawback, the limited substitutability of IREP imports and the costs of rehydration of IREP dried milk, not only make IREP milk products more expensive than CEM but generally make it a less favourable option.⁴⁷²

5.162 Finally, since Canada considers that there is no independent requirement that a subsidy illustrated in paragraph (d) be shown to be contingent on export performance because "every subsidy illustrated in Annex I of the *SCM Agreement* is by definition an Article 1.1 'subsidy' that is contingent on export performance", we decline to independently examine whether Canada's CEM system is contingent on export performance, within the meaning of paragraph (d) of the *Illustrative List*.

(d) Conclusion as to whether "export subsidies" exist

5.163 The Panel recalls its finding in paragraph 5.148 above that the Complainants make a *prima facie* case that export subsidies within the meaning of Article 10.1 exist.

5.164 In light of our analysis in paragraphs 5.152-5.162 above the Panel *finds* that Canada has failed to establish that any of the three required elements of an export subsidy illustrated in paragraph (d) of the *Illustrative List* is not present and that it has therefore also failed to establish that no export subsidies within the meaning of Article 10.1 exist.

5.165 Accordingly, we *find* that Canada provides export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

3. Whether there is circumvention of export subsidy commitments or a threat thereof

5.166 Recalling our considerations set out in paragraphs 5.18-5.19 and in paragraph 5.142 above, the Panel will first examine whether the Complainants make out a *prima facie* case that export subsidies are applied in a manner leading to or threatening to lead to circumvention of export subsidy reduction commitment levels.

(a) Whether the Complainants make a *prima facie* case on circumvention

5.167 The Complainants contend that exporting or adopting measures enabling the export of subsidized products in excess of reduction commitment levels raises a presumption of circumvention or threat thereof.⁴⁷³ The Complainants both argue that because of this presumption, to the extent that dairy products have been exported in excess of Canada's reduction commitment levels, there has been actual

⁴⁷⁰ See paras. 5.134-5.135 above.

⁴⁷¹ See para. 5.116 and footnote 411 above.

⁴⁷² See paras. 5.145-5.146 above.

⁴⁷³ The Panel notes that while only New Zealand explicitly makes this argument, the United States also implicitly makes the same point. See para. 3.165 above.

circumvention.⁴⁷⁴ Because there is no government imposed limit on the amounts of dairy products that may be exported, and because Canada enables subsidization of exports, the Complainants argue, there is a threat of circumvention.⁴⁷⁵

5.168 The Panel, in recalling its finding in paragraph 5.148 and its statement in paragraph 5.166 above, *finds* that the exposition of the Complainants' case in paragraph 5.167 constitutes a *prima facie* case of circumvention or threat thereof such that Canada can reasonably attempt to discharge its burden under Article 10.3 of establishing that the manner of application of export subsidies does not result in or threaten to lead to circumvention of export subsidy reduction commitment levels.

(b) Canada's case on circumvention

5.169 Canada claims that because it does not provide an export subsidy, it is not circumventing its export subsidy commitments.⁴⁷⁶ For this reason, Canada argues that the issue of circumvention is moot.⁴⁷⁷

(c) Panel's examination of the issue of circumvention

5.170 The Panel recalls that it is for Canada, pursuant to Article 10.3, to establish that export subsidies are not being applied so as to circumvent or threaten to circumvent Canada's export subsidy commitments. We take note of Canada's argument that the issue of circumvention becomes moot because it is not providing either a subsidy or an export subsidy.⁴⁷⁸ However, as we have found at paragraph 5.165 above that Canada is providing export subsidies of a type other than those listed in Article 9.1, we do not consider that the issue of circumvention is moot.

(d) Conclusion on the issue of circumvention

5.171 The Panel recalls its finding in paragraph 5.168 above that the Complainants make a *prima facie* showing of circumvention or threat of circumvention of export subsidy reduction commitment levels.

5.172 In light of our consideration in paragraph 5.170 above and because Canada does not make any further arguments on this issue, the Panel *finds* that Canada has failed to establish that export subsidies are not being applied so as to circumvent or threaten to circumvent Canada's export subsidy commitments.

5.173 We therefore also *find* that the manner of application of export subsidies circumvents or threatens to circumvent Canada's export subsidy commitments, within the meaning of Article 10.1.

4. Conclusion on Article 10.1

5.174 Recalling our findings at paragraphs 5.165 and 5.173 above, we *find* that Canada is applying export subsidies of a type not listed in Article 9.1 in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments, inconsistently with Article 10.1 of the *Agreement on Agriculture*. We emphasize that this finding is made in the alternative, in the event that our finding in paragraph 5.136 above with respect to Article 9.1(c) would be overturned on appeal.

⁴⁷⁴ Paras. 3.165 and 3.168 above.

⁴⁷⁵ Paras. 3.165 and 3.167 – 3.168 above.

⁴⁷⁶ Para. 3.169 above.

⁴⁷⁷ *Ibid.*

⁴⁷⁸ See para. 5.169 above.

5.175 Because we have already found in the previous paragraph that Canada has acted inconsistently with its obligations under Article 10.1, we consider it appropriate to exercise judicial economy with respect to the Parties' additional claims on whether "non-commercial transactions" are used to circumvent export subsidy commitments.

G. WHETHER OR NOT EXPORT SUBSIDIES NOT IN CONFORMITY WITH THE AGREEMENT ON AGRICULTURE AND THE COMMITMENTS SPECIFIED IN CANADA'S SCHEDULE ARE PROVIDED, WITHIN THE MEANING OF ARTICLE 8 OF THE AGREEMENT ON AGRICULTURE

5.176 Recalling that Article 8 of the *Agreement on Agriculture* provides that "[e]ach Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement", we also *find* that as a consequence of the violations of either Article 3.3 (through Article 9.1(c)) or Article 10.1, Canada has acted inconsistently with its obligations under Article 8.

H. WHETHER OR NOT CANADA PROVIDES PROHIBITED EXPORT SUBSIDIES WITHIN THE MEANING OF ARTICLE 3.1 OF THE SCM AGREEMENT

5.177 The United States claims, in addition, that Canada's measure is an export subsidy within the meaning of Article 3.1 of the *SCM Agreement*. Canada, in contrast, disputes this claim.

5.178 Because the Panel has found that export subsidies exist, within the meaning of Article 9.1(c) or, in the alternative, Article 10.1 of the *Agreement on Agriculture*, we consider we have made findings sufficient to resolve the matter in dispute. Should the Appellate Body, however, not uphold our finding under Article 9.1(c) and our alternate finding under Article 10.1, we deem the factual record to be complete with respect to making a finding under Article 3.1 of the *SCM Agreement*.

VI. CONCLUSIONS AND RECOMMENDATIONS

6.1 In light of the findings contained in Section V above, the Panel *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 and "other dairy products". In light of our alternative finding in Section V that Canada has acted inconsistently with its obligations under Article 10.1 of the *Agreement on Agriculture*, we conclude that Canada has acted inconsistently with its obligations under Article 8 of the *Agreement on Agriculture*.

6.2 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, 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.

6.3 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*.