

***Canada – Measures Affecting the Importation of Milk
and the Exportation of Dairy Products***

Report of the Panel

The report of the Panel on Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products is being circulated to all Members, pursuant to the DSU. The report is being circulated as an unrestricted document from 17 May 1999 pursuant to the Procedures for the Circulation and Derestriction of WTO Documents (WT/L/160/Rev.1). Members are reminded that in accordance with the DSU only parties to the dispute may appeal a panel report. An appeal shall be limited to issues of law covered in the Panel report and legal interpretations developed by the Panel. There shall be no *ex parte* communications with the Panel or Appellate Body concerning matters under consideration by the Panel or Appellate Body.

Note by the Secretariat: This Panel Report shall be adopted by the Dispute Settlement Body (DSB) within 60 days after the date of its circulation unless a party to the dispute decides to appeal or the DSB decides by consensus not to adopt the report. If the Panel Report is appealed to the Appellate Body, it shall not be considered for adoption by the DSB until after the completion of the appeal. Information on the current status of the Panel Report is available from the WTO Secretariat.

I. INTRODUCTION

1.1 This proceeding has been initiated by two complaining parties, the United States and New Zealand.

1.2 In a communication dated 8 October 1997 (WT/DS103/1), the United States requested consultations with Canada in accordance with Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), pursuant to Article XXII:1 of the General Agreement on Tariffs and Trade 1994 ("GATT 1994"), Article 19 of the Agreement on Agriculture, Article 30 of the Agreement on Subsidies and Countervailing Duties ("the SCM Agreement") and Article 6 of the Agreement on Import Licensing Procedures with respect to export subsidies of Canada on dairy products and the administration by Canada of its tariff-rate quota for fluid milk and cream. The United States and Canada held consultations in Geneva on 19 November 1997 but these consultations did not result in a resolution of the dispute.

1.3 On 29 December 1997 New Zealand requested consultations with Canada pursuant to Article 4 of the DSU, under Article 19 of the Agreement on Agriculture and Article XXII:1 of the GATT 1994 with regard to Canada's Special Milk Classes Scheme. New Zealand and Canada held consultations on 28 January 1998 but these consultations did not result in a resolution of the dispute.

1.4 On 2 February 1998, the United States (WT/DS103/4) and on 12 March 1998, New Zealand (WT/DS113/4), each requested the establishment of a panel with standard terms of reference.

1.5 In its request, the United States claims that:

- (a) "The Government of Canada is providing subsidies, and in particular export subsidies, on dairy products through its national and provincial pricing arrangements for milk and other dairy products without regard to the export subsidy reduction and other WTO commitments undertaken by Canada. Specifically, the Government of Canada established and maintains a system of special milk classes through which it maintains high domestic prices, promotes import substitution, and provides export subsidies for dairy products going into world markets. These practices distort markets for dairy products and adversely affect US sales of dairy products."
- (b) "In addition, although Canada committed under the Marrakesh Agreement Establishing the World Trade Organization to permit access to an in-quota quantity of 64,500 tonnes (product weight basis) under a tariff-rate quota for imports of fluid milk and cream, Canada has refused to permit commercial import shipments within the quota. Instead, Canada is administering this tariff-rate quota in a manner that denies market access."
- (c) "These measures appear to be inconsistent with the obligations of Canada under the General Agreement on Tariffs and Trade 1994 (GATT 1994), the Agreement on Agriculture, the Agreement on Subsidies and Countervailing Measures, and the Agreement on Import Licensing Procedures. The measures in question are the Canadian Dairy Commission Act, agreements of the Canadian Dairy Commission, the Interprovincial Comprehensive Agreement on Special Class Pooling (as well as the P-4, P-6, and P-9 interprovincial pooling agreements), the National Milk Marketing Plan (and amendments thereto), operations of the Canadian Milk Supply Management Committee, the Dairy Products Marketing Regulations, and Canada's administration of its tariff-rate quota on fluid milk and cream (as reflected in its implementation of its WTO Schedule of Concessions)."

- (d) "These measures are inconsistent with the obligations of Canada under Articles II, X, XI, and XIII of the GATT 1994; Articles 3, 4, 8, 9, and 10 of the Agreement on Agriculture; Article 3 of the Agreement on Subsidies and Countervailing Measures; and Articles 1, 2 and 3 of the Agreement on Import Licensing Procedures."

1.6 In its request, New Zealand claims that:

- (a) "The Government of Canada is providing export subsidies on dairy products in contravention of its export subsidy reduction and other WTO commitments as encapsulated by the Agreement on Agriculture and the General Agreement on Tariffs and Trade 1994 (GATT 1994). The dairy export subsidy scheme in question is commonly referred to as the "special milk classes" scheme. The background to, and details of, the "special milk classes" scheme is contained, though not necessarily exclusively, in the following documents:
- (i) the Canadian Dairy Commission Act;
 - (ii) the Comprehensive Agreement on Special Class Pooling (the P9 Agreement);
 - (iii) the National Milk Marketing Plan (NMMP);
 - (iv) the Agreement on All Milk Pooling (the P6 Agreement); and
 - (v) the Western Milk Pooling Agreement (the P4 Agreement)."
- (b) "The "special milk classes" scheme referred to above is inconsistent with Canada's obligations under the following provisions:
- (i) Articles 3, 8, 9 and 10 of the Agreement on Agriculture; and
 - (ii) Article X:1 of the GATT 1994."

1.7 The Dispute Settlement Body (DSB) agreed to each of these requests for a panel at its meeting of 25 March 1998 (WT/DSB/M/44). The DSB further agreed that the two panels be consolidated as a single panel pursuant to Article 9.1 of the DSU with the following standard terms of reference:

"To examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS103/4 and by New Zealand in document WT/DS113/4, the matters referred to the DSB respectively by the United States and New Zealand in these 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".

1.8 On 12 August 1998, the parties to the dispute agreed on the following composition of the Panel:

Chairman: Professor Tommy Koh

Members: Mr. Guillermo Aguilar Alvarez
Professor Ernst-Ulrich Petersmann

1.9 Australia and Japan, and the United States in respect of the New Zealand claims, reserved their rights to participate in the Panel proceedings as third parties.

II. FACTUAL ASPECTS

A. THE CANADIAN DAIRY SECTOR

1. General

2.1 In Canada, milk production is divided into two categories: fluid milk and industrial milk. Of all milk deliveries, approximately 40 per cent is processed into table milk and cream (fluid milk); the remaining 60 per cent is processed into dairy products such as butter, cheese, milk powders, ice cream and yoghurt (industrial milk).¹

2.2 Dairy producers are individual farmers who are licensed to produce milk and sell it, through marketing boards, to dairy processors. The processors are made up of the dairies that process the raw milk for fluid or industrial use, as well as further processors who use the basic dairy components as inputs for other products (such as frozen pizzas, prepared flour mixes, and confectionery). The processors then sell the value-added product on the domestic market or export it on international markets.

2.3 In Canada, there are approximately 23,800 dairy farms which in 1996/97 produced 77.5 million hectolitres of milk, compared to 84,260 dairy farms which produced 75.5 million hectolitres of milk in 1974/75 following the introduction of supply management.² Virtually all production of milk comes from farms that produce for both fluid and industrial markets.

2.4 While fluid milk in general is produced and consumed locally within each of Canada's provinces, industrial milk products move in significant volumes across provincial boundaries or are exported from Canada.

2.5 Quebec and Ontario are the most important dairy-producing provinces in Canada. Quebec is the largest producer of industrial milk, retaining close to 50 per cent of the national share of industrial milk, followed by Ontario with approximately 30 per cent. The dairy processing industry is also centred primarily in Quebec and Ontario.

2. Components of the Canadian Dairy Policy

2.6 The basic components of Canada's supply management system for industrial milk are:

- (a) production quotas;
- (b) administered support prices; and
- (c) border protection.

2.7 Regulatory jurisdiction over trade in dairy products is divided between the federal government and the provinces. While the federal government has constitutional authority over inter-provincial and international trade, other aspects of production and sale of milk are under provincial jurisdiction.

¹ The raw milk provided by the farmer to the processor is usually broken down at the initial stage of processing into its basic "constituents" (cream and skim milk) or into "components" (such as butterfat, protein and other milk solids). The various types of fluid milk (e.g., 3.25 per cent, 2 per cent, 1 per cent) and cream are created by re-blending the cream and skim milk to the desired butterfat content level.

² 1996/97 Annual Report of the Canadian Dairy Commission and Agriculture and Agri-Food Canada: "Long Term Dairy Policy Consultation Paper" (May 1996).

2.8 The federal government pays a subsidy of C\$3.04 per hectolitre for industrial milk produced to meet domestic requirements. To this point in time, this subsidy is being phased out with the subsidy reduction being passed on to the marketplace through support price adjustments. The subsidy is expected to be eliminated by February 2002.

2.9 The federal government maintains tariffs and tariff quotas on imported dairy products. The following table summarizes the base and final bound tariffs for selected dairy products as bound in Canada's WTO Schedule:

Table 1 - Tariff Binding for Selected Dairy Products

Products	Base Tariff	Final Bound Rate (2000)
Milk	283.8%, minimum \$40.6/hl	241.3%, minimum \$34.5/hl
Cheddar Cheese	289.0%, minimum \$4.15/kg	245.6%, minimum \$3.53/kg
Butter	351.4%, minimum \$4.71/kg	298.7%, minimum \$4.00/kg
Yoghurt	279.5%, minimum \$0.55/kg	237.5%, minimum \$0.47/kg
Ice Cream	326.0%, minimum \$1.36/kg	277.1%, minimum \$1.16/kg
Skim Milk Powder	237.2%, minimum \$2.36/kg	201.6%, minimum \$2.01/kg

2.10 Low-rate tariff quota commitments are applicable to the following products and quantities: fluid milk (64,500 tonnes); cream – not concentrated (394 tonnes); concentrated or condensed milk or cream (11.7 tonnes); butter (1,964 tonnes increasing to 3,274 tonnes); cheese (20,412 tonnes); yoghurt (332 tonnes); powdered buttermilk (908 tonnes); dry whey (3,198 tonnes); other products of milk constituents (4,345 tonnes).

2.11 Canada operates an Import for Re-Export Program under the authority of the Export and Import Permits Act.³ Under this programme permits to import dairy products on an Import Control List may be issued by the responsible Minister subject to such conditions as are described in the permit or in the regulations. There are no specific policy guidelines or administrative instructions with respect to this programme, which has been in operation for a number of years. Imports under this programme consist of storable and tradeable components of milk, such as skim and whole milk powders and butter. No permits for milk for manufacturing purposes have been requested by Canadian processors under this program, but fluid milk is imported under the program in retail packages for use on, or eventual re-export by, cruise ships passing through Canada.

3. The Canadian Dairy Commission (the "CDC")

2.12 The Canadian Dairy Commission is a Crown corporation established under the Canadian Dairy Commission Act (the "CDC Act").⁴ Its mandate is set out in the following way in the text of the CDC Act:

³ Canada, Exhibit 35.

⁴ The abbreviation "CDC Act" refers to the CDC Act as amended.

"The objects of the Commission are to provide efficient producers of milk and cream with the opportunity of obtaining a fair return for their labour and investment and to provide consumers of dairy products with a continuous and adequate supply of dairy products of high quality."⁵

2.13 The powers of the CDC are set out in Article 9.(1) of the CDC Act (Box 1).

Box 1	
"9. (1) The Commission may	
(a)	purchase any dairy product and sell, or otherwise dispose of, any dairy product purchased by it;
(b)	package, process, store, ship, insure, import or export any dairy product purchased by the Commission;
(c)	make payments for the benefit of producers of milk and cream for the purpose of stabilizing the price of those products, which payments may be made on the basis of volume, quantity or on any other basis of volume, quality or on any basis that the Commission deems appropriate;
(d)	make investigations into any matter relating to the production, processing or marketing of any dairy product, including the cost of producing, processing or marketing that product;
(e)	undertake and assist in the promotion of the use of dairy products, the improvement of the quality and variety of and the publication of information in relation to those products;
(f)	establish and operate a pool or pools in respect of the marketing of milk or cream, including <ul style="list-style-type: none"> (i) distributing money to producers of milk or cream received from the marketing on any quantity of milk or cream, or any component, class, variety or grade of milk or cream from the pool or pools; (ii) deducting from the money distributed under sub-paragraph (i) any necessary and proper expenses of operating the pool or pools;
(g)	establish the price, or minimum or maximum price, paid or to be paid to the Commission, or to producers of milk or cream, the basis on which that payment is to be made and the terms and manner of payment that is to be made in respect of the marketing of any quantity of milk or cream, or any component, class, variety or grade of milk or cream;
(h)	collect the price paid or to be paid to the Commission, or to any producer in respect of the marketing of any quantity of milk or cream, or any component, class, variety or grade of milk or cream, or recover that price in a court of competent jurisdiction;
(i)	subject to an agreement entered into under section 9.1, establish and operate a programme in respect of the quantities and prices of milk or cream, or of any component, class, variety or grade of milk or cream, necessary for the competitive international trade in, and the promotion and facilitation of the marketing of, dairy products, including: <ul style="list-style-type: none"> (i) distributing money for the purpose of the equalization of returns to producers in respect of that milk or cream, or that component, class, variety or grade, from which those dairy products are made, and (ii) deducting from the money distributed under sub-paragraph (i) any necessary and proper expense of operating the programme; and,
(j)	do all acts and things necessary or incidental to the exercise of any of its powers or the carrying out of any of its functions under this Act."

2.14 The CDC receives its funding from the federal government of Canada as well as from producers and from market transactions.⁶ Its members (a Chairman, Vice-Chairman and Commissioner) are appointed by the federal government, and the CDC is accountable to the federal Parliament, reporting to the Minister of Agriculture and Agri-Food.⁷

2.15 The CDC establishes a national target price for industrial milk, which is an amount deemed to be adequate for producers to cover their costs and receive a fair return on their labour and

⁵ CDC Act, Section 8.

⁶ 1996/1997 Annual Report of the Canadian Dairy Commission, pp. 26 and 28-29.

⁷ CDC Act, Section 4, establishes that: The Commission [CDC] is for all purposes of this Act an agent of Her Majesty in right of Canada.

investments. Using the target price as a basis, the CDC also establishes support prices⁸ for butter and skim milk powder.⁹

4. Provincial Milk Marketing Boards

2.16 In each province a milk marketing board exists. The provincial milk marketing boards operate within a framework established under federal and provincial legislation. The CDC Act defines a board as¹⁰:

"Board' means a body that is constituted under the laws of a province for the purpose of regulating the production for marketing, or the marketing, in intraprovincial trade of any dairy product".

2.17 The provincial milk marketing boards have all been given general authority by the federal and provincial governments in respect of the issuance and administration of quota, the pooling of returns, pricing, producer records keeping and reporting, inspection, and agreements to cooperate with other provinces and the CDC.

2.18 The membership of the provincial milk marketing boards is made up mostly or exclusively of dairy producers.¹¹

2.19 It is prohibited for milk producers to sell any milk individually, without using the provincial milk marketing boards as an intermediary.

2.20 With the exception of 15 producers in Ontario, a producer must have a minimum quota holding to market milk on the domestic or international market.

5. The NMMP

2.21 At a national level, the provincial marketing boards cooperate under the National Milk Marketing Plan (NMMP). The NMMP is signed by the boards for nine¹² of the ten provinces, some provincial government representatives¹³, and the CDC.

⁸ Currently, support prices are only used by the CDC for programmes to buffer domestic supplies seasonally and, to a very minor extent regionally and between processors. This is done through Plans A and B. Under Plan A, the CDC maintains butter stocks to buffer the domestic market against seasonal supply fluctuations. Sales from stocks acquired under this programme in 1996-97 amounted to less than 1 per cent of butter disappearance. Under Plan B, processors may sell butter to the CDC on condition that they repurchase it within the year. Sales of butter covered by this programme amounted to 18 per cent of domestic disappearance in 1996-97.

⁹ 1996/1997 Annual Report of the Canadian Dairy Commission, under "Price Setting".

¹⁰ CDC Act, Section 2 (Definitions).

¹¹ This is true for Ontario and Quebec and all other provinces except Nova Scotia, Alberta and Saskatchewan. In Nova Scotia, the board members are appointed by the provincial government with one member of five to be a producer. In Alberta and Saskatchewan, the provincial governments also appoint the members but historically producers are well represented on the boards. Currently, each five-member board includes two producers, one consumer representative and one processor representative. Nova Scotia, Alberta and Saskatchewan accounted for 1.91 per cent, 4.77 per cent and 2.51 per cent of domestic production in 1997. (Canada, Exhibit 3)

¹² Newfoundland is not a party to the NMMP (its producers produce almost exclusively for the local fluid milk market and it has not traditionally contributed to the industrial milk supply that was the subject of the NMMP).

¹³ Canada, Exhibit 10 contains a full list of signatories.

2.22 The text of the NMMP states that the

"[p]lan is a federal-provincial agreement in respect of the establishment of a National Milk Marketing Plan for the purpose of regulating the marketing of milk and cream products relating to Canadian domestic requirements and for any additional industrial milk requirements in Canada."¹⁴

2.23 The NMMP sets out the structure for the calculation of an annual national production target for industrial milk - the national Market Sharing Quota (MSQ).

2.24 The NMMP is supplemented by:

- (a) the Comprehensive Agreement on Special Class Pooling , (the "P9") which deals with the pooling of revenues from the Special Classes;
- (b) the Western Milk Pooling Agreement (the "P4"); and
- (c) the Agreement on All Milk Pooling (the "P6").

2.25 The Comprehensive Agreement on Special Class Pooling is an Agreement among the authorities of nine provinces and provincial producer boards that are signatories of the NMMP in respect of pooling of revenues from sales of milk components in special classes of milk used to service domestic and external markets. The Agreement provides for the adoption of the Memorandum of Understanding on Special Class Pooling (MOU) and an Addendum to that Memorandum of Understanding.¹⁵

2.26 The powers necessary to create the Special Classes and to administer the Special Milk Classes Scheme were conferred on the CDC by amendment to federal legislation (the CDC Act). It is implemented by the Canadian Milk Supply Management Committee (CMSMC).

6. The CMSMC and the MSQ.

2.27 As noted above, the CMSMC, established under the NMMP¹⁶, is the body that oversees the implementation of the Comprehensive Agreement on Special Class Pooling.¹⁷

2.28 It is composed of representatives of each provincial marketing board and the respective provincial governments.¹⁸ Representatives of the Dairy Farmers of Canada (the "DFC"), the National Dairy Council (the "NDC") representing the dairy processors/exporters, and the Consumers Association of Canada participate although they do not have voting rights. The CDC acts as chair of the CMSMC.

2.29 Based on production and demand forecasts developed by the CMSMC Secretariat (economists from the CDC, the producer boards, the DFC and the NDC), the CMSMC sets the level of the MSQ. The MSQ is monitored and adjusted periodically to reflect changes in demand. Acting

¹⁴ NMMP, A. (Introduction).

¹⁵ Comprehensive Agreement on Special Class Pooling, Introduction.

¹⁶ NMMP, Section H.1.

¹⁷ MOU, Schedule I, Section 1.

¹⁸ Newfoundland sits on the CMSMC as an observer.

under the provisions of the NMMP¹⁹, the CMSMC calculates shares of the MSQ among the provinces.²⁰

2.30 In setting the MSQ, the CMSMC takes into consideration:

- (a) the estimate of domestic demand for industrial milk in the coming year;
- (b) the estimated amount of butterfat that will enter the industrial milk system as surplus from fluid milk production, i.e., the "skim-off";
- (c) anticipated imports;
- (d) stocks of dairy products; and
- (e) planned exports.

2.31 Once a national MSQ has been agreed upon by the CMSMC, the next step is to allocate the MSQ between the provinces. This is done essentially on the basis of historical market shares, with some limited latitude for adjustment through transfers of quota within regional arrangements. Since 1995 the MSQ has been established at the following levels (million hectolitres):

Marketing Year	<u>1995/96</u>	<u>1996/97</u>	<u>1997/98</u>	<u>1998/99</u>
MSQ Level	44.2	44.2	43.3	44.7

2.32 Subsequently, the provincial milk marketing board allocates quotas to individual farmers. In most provinces²¹, the board makes a single allocation²² to each producer, which represents that producer's share of the domestic, and traditional export, milk market. The individual producer's share of the provincial quota, the producer's quota, is determined by the permanent quota rights held by that producer. While quotas were originally allocated on the basis of historic production levels, these quota rights are commercially tradable and, in many cases, have been acquired on a commercial basis.

2.33 In general, CMSMC decisions are taken by consensus. When votes occur, each province that is a member of the NMMP (provincial government representative and producer marketing board representative together) receives one vote. Some votes require a majority while others require unanimous consent. The CDC is empowered to take a decision in the event of a failure by members to agree at two meetings where the question concerns a matter not covered by the Comprehensive Agreement on Special Class Pooling. The Comprehensive Agreement on Special Class Pooling requires unanimity, including on all matters with respect to export trade.

B. THE CANADIAN SPECIAL MILK CLASSES SCHEME

1. Background

2.34 Prior to 1995, the proceeds of levies paid by producers were utilized to fund the CDC's losses in exporting dairy surpluses.

¹⁹ NMMP, Section I, Quota Allocation.

²⁰ 1996/1997 Annual Report of the Canadian Dairy Commission, pp. 7-8.

²¹ In Alberta, producers receive two quotas, one for fluid milk, expressed in litres per day, and one for industrial milk, expressed in kilograms of butterfat per annum.

²² This is usually expressed in kilograms of butterfat per day.

2.35 Following the signing of the WTO Agreement in April 1994, the CDC "directed its activities toward developing alternatives to the use of producer levies".²³ With this in mind, a Dairy Industry Strategic Planning Committee was established. The CDC chaired this Committee and provided research and secretariat support for it. In October 1994, the Committee recommended the implementation of a "classified pricing system based on the end use of milk, national pooling of market returns, and coordinated milk allocation mechanisms."²⁴

2.36 A Negotiating Subcommittee of the CMSMC was established, with representation from all provinces, to resolve how to implement a "special milk classes" scheme. This subcommittee presented its recommendations to federal and provincial Ministers of Agriculture in December 1994, who agreed that "some form of pooling of milk returns was urgently required to enable the dairy industry to meet Canada's international obligations and changing market conditions."²⁵ Ministers also agreed that the CDC Act should be amended to allow the CDC to administer the Special Milk Classes permit and national pooling arrangements. These amendments were passed in July 1995.²⁶

2.37 The Special Milk Classes Scheme, which replaced the producer-financed levy system eliminated in 1995, is embodied in a Comprehensive Agreement on Special Class Pooling. The CDC, the provincial producer boards and the provinces that participate in the NMMP are the signatories of the Comprehensive Agreement on Special Class Pooling which became effective on 1 August 1995.

2. The Special Classes

2.38 The "Special Milk Classes" are the sub-classes of Class 5 milk in the national common classification system, under which the pricing of milk is based upon the end use to which the milk is put by processors. Classes 1 to 4 comprise:

- (a) Class 1: Fluid milk and cream for the domestic market;
- (b) Class 2: Industrial milk for the domestic market: ice cream, yoghurt and sour cream;
- (c) Class 3: Industrial milk for the domestic market: cheese;
- (d) Class 4: Industrial milk for the domestic market: butter, condensed and evaporated milk, milk powders and others.

2.39 The definition of the Special Milk Classes under Class 5 as contained in the Comprehensive Agreement on Special Class Pooling is as follows²⁷:

- (a) Class 5(a) Cheese ingredients for further processing for the domestic and export markets.
- (b) Class 5(b) All other dairy products for further processing for the domestic and export markets.
- (c) Class 5(c) Domestic and export activities of the confectionery sector.

²³ 1994/1995 Annual Report of the Canadian Dairy Commission, page 4.

²⁴ 1994/1995 Annual Report of the Canadian Dairy Commission, pages 3-4.

²⁵ *Ibid.*

²⁶ *Ibid.*

²⁷ Comprehensive Agreement on Special Class Pooling, Annex A.

- (d) Class 5(d) Specific negotiated exports including cheese under quota destined for United States and United Kingdom markets, evaporated milk, whole milk powder and niche markets.
- (e) Class 5(e) Surplus removal.

2.40 Class 5(e), which is referred to as "surplus removal", is made up of both in-quota and over-quota milk. The over-quota portion of Class 5(e) represents the production that is in excess of the MSQ. The in-quota portion of Class 5(e) exports represents the milk production that is surplus to domestic and planned export needs. This "surplus" may be derived either from the:

- (a) "sleeve"²⁸;
- (b) structural surplus of solids non-fat²⁹ resulting from setting the MSQ at a level that meets demand for butterfat; or
- (c) other in-quota surpluses.³⁰

2.41 Table 2 shows Canada's total exports compared to their export volume commitments under the WTO. Canada also provided data on the amount of exports generated through Classes 5(d) and (e) but requested that this data be kept confidential on the ground that the amounts for some entries make identification of individuals possible. The figures provided indicate that the total amount of exports generated through Classes 5(d) and (e) exceeds Canada's export quantity commitment level in respect of all three marketing years and this for all products contained in Table 2 other than skim milk powder (see also paragraph 7.115).

Table 2

Product	Marketing year	Export Quantity commitment level	Total exports ³¹	Total exports generated through Classes 5(d) and (e) ³²
Butter	1995/1996	9,464	13,956	
	1996/1997	8,271	10,987	
	1997/1998	7,079	10,894	
Cheese	1995/1996	12,448	13,751	
	1996/1997	11,773	20,409	
	1997/1998	11,099	27,397	
Skim milk powder	1995/1996	54,910	35,252	
	1996/1997	52,919	24,888	
	1997/1998	50,927	29,886	
Other milk products	1995/1996	36,990	37,573	
	1996/1997	35,649	62,146	
	1997/1998	34,307	71,023	

²⁸ The "sleeve" is a safety margin built into the annual estimate of Canadian domestic requirements – its purpose is to cover for any unexpected changes in domestic demand in the course of the dairy year.

²⁹ This structural surplus, which consists of skim milk powder, had declined in recent years to about 17,800 tonnes of skim milk powder.

³⁰ Such surpluses could arise where there is a temporary imbalance in supply and demand, such that milk is available in a province which is not needed immediately on the domestic market in that province. This can also be described as seasonal variation in demand through the year.

³¹ Data provided in response to Panel Question: Source of Total Exports: Statistics Canada.

³² The data provided by Canada in response to Panel questions on exports generated through Classes (d) and (e), which is more extensive than that reproduced in paragraph 7.114 below, is on record and is available to the Appellate Body as necessary.

3. In-quota milk and over-quota milk

2.42 A national production quota (the national MSQ) for industrial milk is set each year by the CMSMC (paragraph 2.29 and 2.30). Each province is allocated a share of the MSQ which is then allocated among producers within a province by the various provincial milk marketing boards and agencies.

2.43 If a province exceeds its share of the MSQ, the milk that is in excess of the province's share of the MSQ is referred to as "over-quota" milk (further detail in paragraph 2.57). If a province does not exceed its share of the MSQ, all of the province's milk is referred to as "in-quota" milk.

2.44 Prior to 1995, the percentage of farmers producing in excess of 105 per cent³³ of their allocated quota was small. In 1994-95, only 10 per cent of producers were in this group, a figure consistent with levels observed since 1992. A year later, under the new system, 25 per cent of farmers produced over 105 per cent of quota. By 1997-98, 34 per cent of Canadian producers were producing over 105 per cent of their quota.

2.45 In each of the regional pooling arrangements, fluid milk requirements are estimated on a regional basis, based on previous years' consumption. Since fluid milk demand is the highest priority use for milk supplies in the system, the industrial milk system acts as a buffer for any fluctuations in fluid milk demand or supply. In the event of a milk shortage, for instance, milk that would otherwise have found an industrial use is sent into the fluid milk system to cover the shortfall.

2.46 Each province's share of the total in-quota milk market is the sum of its share of the MSQ and the fluid milk market within its regional pooling arrangement.

4. The price of milk to the processor

(a) Other Classes (Classes 1 – 4)

2.47 The prices in Classes 1-4 reflect the target return for sales on the domestic market. Although the prices for these classes are established independently in each province by the provincial marketing boards, the boards have agreed in the regional pooling arrangements not to have large differences in these prices.

(b) Class 5 (Special Classes)

2.48 To obtain dairy products under Class 5, the processors/exporters must apply for a permit from the CDC. A permit holder then presents the permit to the relevant provincial marketing board or marketing agency, which upon acceptance of the recommendation contained therein, provides the milk for export.

³³ This is based on the assumption that 105 per cent of quota is a level that reflects a deliberate decision to produce for the over-quota market, allowing for other factors such as weather and biological variability in milk production that may cause producers not to meet their quotas exactly.

2.49 The CDC issues two types of permit for Class 5 milk:

- (a) The first type of permit applies to the activities under Classes 5(a), 5(b), and 5(c) and is issued to processors/exporters on an annual basis.
- (b) The second type of permit applies to Classes 5(d) and (e) and is issued to exporters on a transaction-by-transaction basis.

2.50 Prices in Classes 5(a) and (b) are set through a formula negotiated in and decided upon by the CMSMC. This formula links Class 5(a) and (b) prices to US industrial milk prices. The CDC collects the data and does the necessary calculations for the consideration of the CMSMC. The price of milk in Class 5(c) is negotiated between the CMSMC and the confectionery manufacturers.

2.51 Prices for Classes 5(d) and (e) are negotiated and established on a case-by-case basis with the processors/exporters. The CDC conducts these negotiations in accordance with the criteria agreed upon in the CMSMC.

**Table 3 - Average Selected Milk Component Prices by Class and Product
January to June 1997**

Class	Product	Component Prices (\$/kg.)			\$/hl
		BF	Protein	OS	Total
1a)	Fluid milk	5.46	6.56	3.70	61.61
1b)	Table Cream	5.43	5.22	3.58	56.62
2)	Yoghurt and Ice Cream	5.43	4.00	3.89	54.37
3a)	Specialty Cheeses	5.47	9.04	0.58	51.78
3b)	Cheddar Cheese	5.48	8.59	0.58	50.40
4a)	Butter, Ingredients	5.4	3.51	3.51	50.82
4b)	Condensed Milk	5.44	3.62	3.62	51.71
5a)	Specialty Cheeses	2.99	7.01	0.57	36.37
5a)	Cheddar Cheese	3.05	7.01	0.57	36.55
5b)	Fluid Milk	3.08	2.92	2.92	37.00
5b)	Creams	3.05	2.92	2.92	36.89
5b)	Yoghurt	3.05	2.92	2.92	36.91
5b)	Butter, Ingredients	2.98	2.91	2.94	36.75
5c)	Milk products for Confectionery	2.64	2.59	2.59	32.51
5d)	Milk	2.18	2.18	2.12	27.28
5d)	Cream	2.46	2.46	2.46	30.69
5d)	Yoghurt	2.57	2.57	2.57	32.06
5d)	Specialty Cheeses	1.94	4.87	0.51	25.37
5d)	Cheddar Cheese	3.97	6.72	0.51	38.56
5d)	Butter	1.83	1.83	1.83	24.91
5e)	Milk	2.15	2.15	2.15	26.87
5e)	Cream	2.20	2.20	2.20	27.47
5e)	Specialty Cheeses	1.50	4.54	0.51	22.75
5e)	Cheddar Cheese	1.86	4.92	0.51	25.23
5e)	Butter	1.28	1.28	1.28	15.98

Notes: BF = butterfat, hl = 100 litres, OS = other solids

One hectolitre of milk = approximately 3.6 kg. of butterfat, 3.2 kg. of protein and 5.7 kg. of other solids.

Source: United States, Exhibit 22, *An Inquiry Into the Importation of Dairy Product Blends Outside the Coverage of Canada's Tariff-Rate Quotas*, Report of the Canadian International Trade Tribunal, June 1998 p. 13 (source referred to in United States, Exhibit 22: Canadian Dairy Commission).

5. Returns to producers from exports

(a) General

2.52 Exports of dairy products from Canada fall within two categories, exports that result from:

- (a) milk from in-quota sources such as planned production for exports to traditional markets and the part of the sleeve not used in domestic markets;
- (b) milk that is the result of over-quota production.

(b) In-quota exports

2.53 In-quota milk for export use consists of milk that falls within the annual MSQ but is not used for the domestic market. It is sourced from a fixed amount set aside for planned export within Class 5(d), as well as MSQ milk surplus to domestic requirements (under Class 5(e)).

2.54 The CMSMC specifies the amount of sales under Class 5(d), currently 1.2 million hectolitres. Exporters with access to these traditional markets approach the CDC with proposals to purchase milk under Class 5(d).³⁴ Sales of surplus milk (i.e., Class 5(e)) begin with a declaration that milk surplus to domestic requirements is available. The determination whether there is in fact milk available in system surplus to domestic and traditional export market requirements is made by the Surplus Removal Committee, which is formally known as CDC Advisory Group on Preemptive Surplus Removal (hereafter the "SRC") of the CMSMC. If the SRC determines that milk is available³⁵ and the CDC believes that the proposal should be accepted, it provides a permit to the exporter that is subject to acceptance by the relevant board. This permit carries a recommendation to the board that the required amount of milk should be supplied at the recommended price.

2.55 Once the exporter has agreed on a milk price with the board it may export the resulting processed products. It keeps the export documentation available for examination by the CDC auditors. To allow the CDC to maintain its monitoring programme on behalf of the CMSMC, the exporter is also required to file proof of export with the CDC. All holders of such permits must provide the CDC with regular reports on their dairy ingredient purchases and use.

2.56 The returns to the producer for in-quota milk sold for export use are based on world market conditions, resulting from prices negotiated between the processor/exporter and the CDC. These returns are subject to pooling with domestic market returns before receipt by the individual producers.

(c) Over-quota exports

2.57 Exports of dairy products produced with over-quota milk may arise in two ways:

- (a) Over-quota production: There are production quotas at the individual farm level and at the provincial level. At the provincial level, over-quota production occurs when producers in a province produce milk in excess of their individual quotas and as a result a province as a whole exceeds its share of the national MSQ in a defined period of time. Independent of the level of production in a province as a whole, at the farm level, an individual producer may exceed his individual farm production quota. It is

³⁴ These traditional sales are linked to certain trade opportunities, such as TRQs that are traditionally made available to Canadian exporters, as well as sales arising out of long-term trade patterns. The main markets for Class 5(d) transactions are aged cheddar to the U.K, cheese to the United States under Canada-specific tariff quotas, cheese to Mexico, mainly evaporated milk to Libya, skim milk powder and whole milk powder to Algeria and skim milk powder, whole milk powder and evaporated milk to Cuba.

³⁵ The Comprehensive Agreement on Special Class Pooling states that the CDC will be guided by the decisions of the SRC.

noted that returns to the producer are calculated on the basis of the over-quota production at the individual level.

- (b) Optional Export Program (OEP): The OEP is a programme whereby milk is produced in addition to quotas and sold outside of the classification system to meet a specific marketing need.³⁶ OEP contracts are negotiated between the producer marketing board and a processor. The board then offers the agreed terms to the producers who can voluntarily accept to produce for the OEP contract.

2.58 The returns to the producer from over-quota production is based on a three month average reflecting actual Class 5(e) prices, as calculated by the CDC. At year's end, returns during the year for over-quota milk are adjusted to reflect actual total returns. Over-quota returns through Class 5(e) sales are not pooled with the domestic market returns before being paid to the individual producer. Returns from sales under the OEP are likewise, not pooled with the domestic market returns before being paid to the individual producer.

6. Pooling

2.59 Pooling calculations are made under the Comprehensive Agreement on Special Milk Classes (P9).

2.60 Revenues from all in-quota sales of milk are pooled between provinces in two regional pools (Table 4).

Table 4

P6 Agreement on All Milk Pooling	P4 Western Milk Pooling Agreement
Ontario	British Columbia
Quebec	Alberta
New Brunswick	Saskatchewan
Nova Scotia	
Prince Edward Island	
Manitoba <i>Note: Manitoba currently belongs to both pools. It first pools its revenues under the P4, then under the P6.</i>	
P9 Comprehensive Agreement on Special Class Pooling "National Pool" (all 9 provinces)	

³⁶ This is to be contrasted with over-quota production. Over-quota production is also produced over and above quotas but is not linked to any specific export market need. Producers are paid for OEP milk on the basis of the prior negotiated price, whereas the board pays the producer for over-quota milk on the basis of actual returns on Class 5(e) sales, i.e., returns from sales made in the spot market. The OEP Agreement is Annex C of the Comprehensive Agreement on Special Milk Classes (P9).

2.61 The pooling process is illustrated by way of an example with the following assumptions:

ASSUMPTIONS

- Production		P4	P5	P9
	Class 1-4	15 hl	45 hl	
	Class 5 in-quota	2 hl	5 hl	
	Total	17 hl*	50 hl	67 hl
- Actual returns				
	Class 1-4	\$58 / hl	\$55 / hl	
	Class 5	\$21 / hl	\$22 / hl	
- Target return: (Class 1-4): \$54.00 / hl				
* Includes 3 hl from Manitoba.				

2.62 There are four steps in the pooling process:

STEP 1

Remove from pooling calculations sales from:

- **Over-quota.**
- **Optional Export Programme.**

STEP 2

Pool Class 5 in-quota: at **actual price obtained.**
 Pool Classes 1-4: at the **target price: \$54.00 / hl.**

Gives: Revenue to be pooled by region.

REGIONS:	P4	P5	P6	P9
Target Revenue @ \$54.00 / hl.				
Class 1-4	\$810	\$2,430		
Class 5 (@ \$21 and \$22 / hl)	\$42	\$110		
Total	\$852	\$2,540		\$3,392

STEP 3

Class 5 in-quota is pooled with all Classes. Gives: **Average return, all classes.**
Adjustment between regional pools is calculated

REGIONS:	P4	P5	P6	P9
Class 5 is pooled in all Classes				
\$3,392 / 67 hl				\$50.63 / hl
Revenue at:				
Target return				
total in Step 2	\$852	\$2,540		
Pooled return (all classes)				
@ \$50.63 / hl	\$861	\$2,531		
Difference (Adjustment)	+\$9	-\$9		

STEP 4

Pool the P4 at actual market returns from all milk sales. Apply the adjustment for P9.

Pool P5 at actual market returns from all milk sales.
 Manitoba adds revenues from P4 into the P5. **This becomes the P6.**

Pool the P6 at actual returns from all milk sales. Apply the adjustment for P9.

REGIONS:	P4	P5	P6	P9
Actual revenue				
Class 1-4 (@ \$58 and \$55 / hl)	\$870	\$2,475		
Class 5 (@ \$21 and 22 / hl)	\$42	\$110		
Total	\$912	\$2,585		\$3,497
Adjusted revenue	+\$9	-\$9		
Total	\$921	→	\$2,576	
Quantity (P4)	17 hl		50 hl	
Average Return (P4)	\$54.18 / hl			
+ Manitoba (3hl @ 54.18)			+\$162.5	
Total Return P6			\$2,738.5	
Quantity (P6)			53 hl	
Average Return P6			\$51.67 / hl	

2.63 The result is that each provincial board in a regional pooling arrangement receives:

- (a) a regional average return for all its Class 1-4 sales;
- (b) a national average return for all of its adjusted Class 5 sales derived from in-quota milk; and
- (c) an average world market return for any over-quota shipments.

C. CANADA'S TARIFF-RATE QUOTA ON FLUID MILK AND CREAM

2.64 In Canada's WTO Schedule V, the tariff-rate quota for fluid milk (HS 0401.10.10) is 64,500 tonnes (product weight basis). The following text is contained under "other terms and conditions":

"This quantity represents the estimated annual cross-border purchases imported by Canadian consumers."

2.65 Currently, Canada does not impose any monitoring of cross-border imports of consumer packaged milk (limited to the value of C\$20.00 per entry).

2.66 Canada has applied the over-quota tariff to fluid milk shipments in commercial containers or in bulk. As noted above in paragraph 2.11, no permits have been issued for imports of milk (HS 0401) for industrial use under the Import for Re-Export Program.

III. CLAIMS OF THE PARTIES

A. EXPORTATION OF DAIRY PRODUCTS

1. Product coverage and period of time

3.1 The dairy products and marketing years covered by the claims of **New Zealand** and the **United States** are set out in Table 1 below.

Table - Products¹ and marketing years² subject to the complainants' claims

	Butter	Cheese	Other Milk Products
New Zealand	1995/96 1996/97	1995/96 1996/97	1996/97
United States	1996/97	1996/97	1996/97

¹ Butter consists of products classified in 0405.10 and 0405.90. Cheese consists of products provided for in 0406.10, 0406.20, 0406.30, 0406.40, and 0406.90. Other Milk Products includes milk and cream in 0401.10, 0401.20, 0401.30; powdered whole milk and cream in 0402.21 and 0402.29; condensed evaporated milk in 0402.91 and 0402.99; buttermilk and yoghurt in 0403.10 and 0403.90; milk protein concentrate, 0404.90; and ice cream, 2105.00. Although the United States understood that Canadian exports of Skim Milk Powder were not in excess of Canada's WTO commitments, the United States considered that all exports under the SMP category that were exported through the Special Milk Classes Scheme should have been notified as subsidies to the WTO.

² New Zealand did not refer to the marketing year 1997/98 because official figures for that period were not available. Nevertheless, if those figures were to indicate that Canada's actual exports also for that period exceeded its reduction commitments in respect of the products mentioned in the table, New Zealand would consider that Canada had also breached its WTO obligations in respect of those products for the 1997/98 marketing year. The United States noted that although Canada had not yet reported to the WTO its export quantities for the 1997/98 period, based on preliminary information for that period, the volume of exports appeared to remain at levels exceeding the pertinent reduction commitments. After our first substantive meeting, the figures for marketing year 1997/1998 became available and are incorporated above in Table 2 in para.2.41.

2. Nature of Measure

3.2 **New Zealand** and the **United States** claimed that there was extensive government involvement in all critical aspects of Canada's Special Milk Classes Scheme, from its initiation through to its administration and operation. Canada's Special Milk Classes Scheme was a product of governmental authority and was operated under the auspices of the federal and provincial governments. This government involvement in the scheme was sufficient to constitute government action within the meaning of the jurisprudence developed by GATT and WTO panels.

3.3 **Canada** claimed that the Complainants' assumptions of government control, direction or mandate were without basis in fact and were, therefore unsustainable. Government involvement was limited to providing an appropriate regulatory framework and essentially responsive to the initiatives of the Canadian dairy industry.

3. Agreement on Agriculture

(a) Article 1(e)

3.4 Both **New Zealand** and the **United States** claimed that the Special Milk Classes Scheme was an export subsidy in the sense of Article 1(e) of the Agreement on Agriculture.

3.5 **Canada** claimed that as the sales of milk at differing prices under Special Classes 5(d) and (e) did not constitute a "subsidy" pursuant to the definition of the SCM Agreement, it followed that these sales could not constitute a subsidy for the purposes of the Agreement on Agriculture. Therefore, by definition, such sales could not constitute an "export subsidy" within the meaning of the definition in Article 1(e) of the Agreement on Agriculture.

(b) Article 9.1(a) and (c)

3.6 **New Zealand** and the **United States** claimed that the Special Milk Classes Scheme constituted export subsidy practices listed in Article 9.1(a) and (c). As such, these practices were subject to reduction commitments under the Agreement on Agriculture. **Canada** refuted both these claims.

(c) Article 3.3 and Article 8

3.7 **New Zealand** and the **United States** claimed that Canada's provision of export subsidies under Article 9.1(a) and (c) of the Agreement on Agriculture in excess of its scheduled export subsidy commitments was a violation of Article 3.3 of that Agreement. Furthermore, Canada was in violation of its obligation under Article 8 of the Agreement on Agriculture not to provide export subsidies otherwise than in conformity with the Agreement on Agriculture.

3.8 **Canada** claimed that since the sales of milk at differing prices for domestic and export markets did not constitute an "export subsidy" as that term was defined in Article 1(e) of Agreement on Agriculture, the practice at issue did not fall within the scope of Article 8; that article could therefore not apply.

(d) Article 10

3.9 Alternatively, **New Zealand** and the **United States** claimed that Special Classes 5(d) and (e) of the Special Milk Classes Scheme constituted an export subsidy not listed in Article 9.1 that was being applied in a manner which circumvented or threatened to lead to circumvention of Canada's export subsidy commitments contrary to Article 10.1 and 10.3 of the Agreement on Agriculture.

3.10 **Canada** claimed that Article 10 did not apply in the present case as it could not be established that there existed "export subsidies", including those export subsidies listed in Article 9.1. Nor could it be established that there was actual or threatened circumvention of Canadian export subsidy commitments.

4. Agreement on Subsidies and Countervailing Measures ("SCM Agreement")

(a) Article 1 and Paragraph (d) of the Illustrative List of Export Subsidies in Annex I

3.11 **New Zealand** and the **United States** claimed that even on the basis of Canada's own approach to the interpretation of the term "subsidy" Canada had not shown that the Special Milk Classes Scheme fell outside the definition of subsidy under the SCM Agreement. The Scheme constituted a subsidy within the meaning of Article 1 of the SCM Agreement. In addition, that the

Special Milk Classes Scheme constituted the provision of an export subsidy within the meaning of Paragraph (d) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement.

3.12 **Canada** claimed that the sale of milk at differing prices did not constitute a "subsidy" within the meaning of Article 1 of the SCM Agreement. Further, Canada claimed that the practices at issue were not "export subsidies" in the sense of Paragraph (d) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement.

(b) Article 3

3.13 The **United States** claimed that as Canada's Special Milk Classes Scheme was inconsistent with Canada's obligations under the Agreement on Agriculture it was consequently in violation of Article 3 of the SCM Agreement.

B. IMPORTATION OF MILK

1. Article II of GATT 1994 and the Agreement on Import Licensing Procedures

3.14 The **United States** claimed that Canada's administration of its tariff-rate quota on fluid milk³⁷ which restricted access to the in-quota quantity of its tariff-rate quota for fluid milk to entries that were valued at less than C\$20 and that were for the personal consumption of Canadian residents, was inconsistent with its obligations under Article II:1(b) of GATT 1994 and Article 3 of the Agreement on Import Licensing Procedures.

3.15 **Canada** claimed that its current treatment of fluid milk imports was fully consistent with the terms and conditions of the tariff concession for fluid milk (HS 0401.10.10) in its Schedule. Canada further refuted any alleged violation of the Import Licensing Agreement.

C. RECOMMENDATIONS REQUESTED BY THE PARTIES

3.16 **New Zealand** requested that the Panel, in accordance with Article 19 of the DSU, recommend that Canada bring its measures into conformity with the Agreement on Agriculture.

3.17 The **United States** requested that the Panel find the Canadian Special Milk Classes Scheme and the denial of access to imports under the tariff-rate quota on fluid milk and cream to be inconsistent with Canada's WTO obligations. Accordingly, the Panel should recommend that Canada bring those measures into conformity with its obligations under the GATT 1994, the Agreement on Agriculture, the Agreement on Subsidies and Countervailing Measures, and the Agreement on Import Licensing Procedures. More specifically, the Panel should recommend (i) that Canada either withdraw its export subsidies or reduce the level of its subsidized exports of dairy products to a level commensurate with its reduction commitments and (ii) that such action be taken without delay. In this regard, the United States saw no reason why Canada could not bring its export subsidies into compliance within 30 days of the adoption by the Dispute Settlement Body of recommendations and rulings. With respect to market access, the United States respectfully submitted that the Panel should recommend that Canada not apply its tariff-rate quota in a manner that denies entry at the in-quota rate to any fluid milk imports made within the quantitative limit of the tariff-rate quota.

3.18 **Canada** requested the Panel to find that (i) Canada's Special Milk Classes did not provide an export subsidy and thus did not violate Canada's obligations under Articles 8, 9 or 10 of the

³⁷ The specific products subject to this claim were classified in Canada's tariff schedule within tariff item numbers 0401.10 and 0401.20. The US claim relating to Canada's fluid milk tariff-rate quota related to the last three years (1995-1997) as well as the current year (1998).

Agreement on Agriculture nor under Article 3 of the SCM Agreement; and (ii) that Canada's administration of its tariff-rate quota on fluid milk and cream was consistent with Canada's obligations under Article II:1(b) of the GATT 1994 and Article 3 of the Agreement on Import Licensing Procedures. Canada requested the Panel to dismiss all claims brought against Canada in this case by the United States and New Zealand.

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

VI. INTERIM REVIEW

6.1 On 5 February 1999, the Panel issued its interim report to the parties. On 18 February, Canada and the United States requested the Panel to review precise aspects of the interim report, in accordance with Article 15.2 of the DSU. New Zealand did not seek review of any aspect of the interim report. Neither of the three parties requested the Panel to hold a further meeting. We subsequently allowed the parties to comment on the comments we received on 18 February. On 26 February, all three parties submitted such comments.

6.2 Canada suggested that certain corrections and additions be made to the descriptive part of our report. The complainants did not object to these corrections and additions. Where appropriate, we redrafted the relevant sections accordingly. Canada also noted that Table 2 in paragraph 2.41 of our report contains confidential data. We deleted the relevant data from the last column of Table 2, inserted an appropriate footnote regarding the availability of this data in any appeal proceedings, and expressed the indications we derived from this column in paragraph 2.41. We kept the remaining columns in Table 2 since the data contained therein was already made public by Canada in its notifications under the Agreement on Agriculture.

6.3 On the basis of factual comments received by Canada we also redrafted paragraphs 7.54 and 7.59.

6.4 We incorporated certain US suggestions in the descriptive part of our report. Other suggestions had already been taken into account as a result of US comments on the descriptive part of our report. In the light, *inter alia*, of Canada's objections to other US requests for review, we did not add language to paragraphs 7.10, 7.48 and 7.152 of our report.

6.5 The United States further suggested deleting the reference made in the interim report to the concept of "obiter dicta" in respect of our examination under Article 10 of the Agreement on Agriculture. We followed this suggestion (to which Canada did not object and with which New Zealand agreed) in order to clarify the matter. We stress, however, that our examination and findings under Article 10 are made in the alternative, i.e., in the event our findings under Article 9.1 should not be adopted and the DSB decides the dispute based on the alternative claims of violation of Article 10. Accordingly, we redrafted paragraphs 7.119, 7.136 and 8.1 and footnote 530

VII. FINDINGS

A. CLAIMS OF THE PARTIES

1. The Special Milk Classes Scheme

7.1 New Zealand and the United States claim that the volume of Canadian exports of certain dairy products, under a scheme known as "Special Milk Classes", exceeds Canada's export subsidy commitments. Pursuant to this scheme, milk is classified into five Classes according to its end use and market destination. Classes 1 to 4 cover milk for use on the domestic market. Class 5 - the so-called "Special Class" – applies to milk intended for export as well as milk for use in products which face import competition in the domestic market. Class 5 is further subdivided into five sub-classes. Classes 5(d) and (e) apply exclusively to milk for use in exported products. Class 5(d) consists of the so-called "traditional planned exports". Class 5(e) covers milk that is to be exported for surplus removal purposes.³⁷²

7.2 Both complainants focus on Classes 5(d) and (e) of the Special Milk Classes Scheme.³⁷³ They consider that these Classes in the context of Canada's supply and price management system constitute:

- (a) an export subsidy in the sense of Article 9.1 of the Agreement on Agriculture which should be counted against Canada's export subsidy reduction commitments; or, in the alternative,
- (b) an export subsidy not listed in Article 9.1 which is applied in a manner which results in, or threatens to lead to, circumvention of Canada's export subsidy commitments, contrary to Article 10.1 of the Agreement on Agriculture.

The complainants conclude that under both alternatives the scheme results in export subsidies granted contrary to the Agreement on Agriculture (in particular, Article 3.3, Article 8 and/or Article 10.1 thereof).

7.3 The United States further claims that, to the extent that the scheme is an export subsidy contrary to the Agreement on Agriculture, it also violates Article 3 of the Agreement on Subsidies and Countervailing Measures ("SCM Agreement") which prohibits export subsidies.

7.4 The dairy products in question are: butter, cheese and "other milk products". The relevant marketing years are: 1995/1996 and 1996/1997.³⁷⁴ Both complainants also refer to marketing year 1997/1998 which ended on 31 July 1998 and for which data only became available - and was submitted to us - after our first substantive meeting. However, in doing so neither of the complainants explicitly incorporated this marketing year under its claims. Since, moreover, marketing year

³⁷² See paras. 2.38 - 2.40.

³⁷³ New Zealand's claims only cover Classes 5(d) and (e). The United States, on the other hand, submits that subsidized exports are made under each of the Special Classes but – as it states in its answer to Panel Question 1 to the complainants – "places particular emphasis on the subsidized exports occurring as a result of the operation of Special Classes 5(d) and (e)". Below, the Panel also addresses Classes 5(a) to (c) which cover milk for domestic use as well as milk for export. See para. 7.41 and footnotes 453 and 496.

³⁷⁴ See Table 1 in para. 3.1 above. The US claims only cover marketing year 1996/1997 but this for all three products (US answer to Panel Question 2 to the complainants). The claims by New Zealand cover both marketing years 1995/1996 and 1996/1997 and this in both cases for all three products at issue, except that "other milk products" are not included for marketing year 1995/1996 (New Zealand answer to Panel Question 2 to the complainants).

1997/1998 only ended some four months *after* the establishment of this Panel (on 25 March 1998), we are not called upon to make findings in respect of that marketing year.³⁷⁵

7.5 In response Canada argues that the Special Milk Classes Scheme does not constitute an export subsidy either:

- (a) in the general sense covered by the Agreement on Agriculture (in so doing Canada refers in particular to Article 1 of the SCM Agreement, arguing that the scheme is not a "subsidy" and can therefore *a priori* not be an "export subsidy"); or
- (b) in the specific sense stipulated in any of the six sub-paragraphs of Article 9.1 or in Article 10.1 of the Agreement on Agriculture.

Canada submits that since the exports subject to this scheme are, therefore, not generated by export subsidies, they do not have to be counted against its scheduled reduction commitments, nor can they constitute a circumvention of these commitments in the sense of Article 10.1. Canada concludes, therefore, that the Special Milk Classes Scheme fully conforms to both the Agreement on Agriculture and to the SCM Agreement.

2. The tariff-rate quota for fluid milk

7.6 The United States also claims that access to the tariff-rate quota for fluid milk - which Canada granted in the Uruguay Round negotiations - is being restricted contrary to Canada's obligations under Article II of GATT 1994 and Article 3 of the Agreement on Import Licensing Procedures. The restrictions referred to are as follows: (i) entries are only allowed for consumer packaged milk for personal use by Canadians; and (ii) entries are limited to those valued at less than C\$20.

7.7 To this claim, Canada responds that in its Schedule it limited access to the tariff-rate quota to cross border imports of consumer packaged milk by Canadians for personal use. Canada claims that this is clear from the "terms and conditions" attached to this concession in its Schedule, as well as from the negotiating history that led to this concession.

3. Other claims raised in the requests for this Panel

7.8 We note that the requests by the United States and New Zealand for the establishment of this Panel also alleged violations of Articles X, XI and XIII of GATT 1994. However, neither the United States nor New Zealand further pursued any of these claims during the Panel proceedings.

B. THE SPECIAL MILK CLASSES SCHEME

1. Summary of claims and arguments of the parties

- (a) New Zealand and the United States

7.9 New Zealand and the United States claim that under Classes 5(d) and (e), processors of dairy products for export are given access to milk at prices lower than those applying to milk for the manufacture of the same products for domestic consumption. In their view, this is done in order to

³⁷⁵ Our terms of reference, set out in document WT/DS103/5 and WT/DS113/5, only mandate us to "examine, in the light of the relevant provisions of the covered agreements cited by the United States in document WT/DS103/4 and by New Zealand in document WT/DS113/4, the matters referred to the DSB respectively by the United States and New Zealand in these documents" (emphases added). These documents, the requests for this Panel, were submitted to the DSB and incorporated in our terms of reference on 25 March 1998. The matters referred to therein, and thereby subjected to our review, do not include within their scope marketing year 1997/1998.

remove surpluses of milk in a way that allows Canadian processors/exporters of dairy products to compete in export markets.

7.10 With respect to milk produced within the limits of the allocated producer quotas ("in-quota milk"), the Complainants argue that making milk available for use in exports at lower prices - under either Class 5(d) or (e) - can only be sustained because of the government's involvement, in particular the governmentally-imposed pooling of the relatively low returns from these exports with the higher returns obtained from milk sold for use on the domestic market. On these grounds, New Zealand and the United States submit that Classes 5(d) and (e) constitute an export subsidy whereby, as a result of extensive governmental involvement, *producers* are required to share the cost of selling milk at lower prices for export use and *processors/exporters* benefit from the cheaper milk made available to them to be competitive on export markets. In their view, the mechanism stimulates the removal of milk surpluses by way of exports.

7.11 In response to questions put to them by the Panel, the complainants clarified that their claims also cover exports generated under Class 5(e) from milk produced *in excess of* the allocated producer quotas ("over-quota milk"). This milk, as well, is sold for export at a lower price than the domestic milk price. However, as opposed to in-quota milk sold for export, the relatively low revenues from over-quota milk for export are generally *not* pooled with the higher revenues from milk used domestically. Nevertheless, for the complainants, the extent of federal and provincial governmental involvement in the arrangements under which milk is made available for export at lower prices – irrespective of whether the returns are pooled - suffices to conclude that the dairy products produced with over-quota milk are being exported with the help of export subsidies. According to the complainants, it is irrelevant for the processor producing for export - who can buy the milk at a cheaper price - whether the milk was produced in- or over-quota. The complainants submit that the competitive benefit thereby granted to processors/exporters could not exist without the governmentally established and enforced Special Milk Classes Scheme and that this benefit thus constitutes an export subsidy.

(b) Canada

7.12 Canada argues that the Special Milk Classes Scheme is producer driven and not directed by the government. Canada submits that milk producers producing for export follow commercial considerations and react to world market signals, not to government directions. According to Canada, the government does play a role in the scheme but one that is limited and essentially responsive to the initiatives of the industry. For Canada, the government only has an oversight function to protect the public interest.

7.13 With respect to in-quota milk sold for export, Canada argues that producers are free to collectively determine whether and to what extent they wish to provide in-quota milk for export purposes. According to Canada, the lack of government control, direction or coercion in exporting milk at a lower price is even more apparent with respect to over-quota milk. Canada submits that any qualified dairy producer in Canada is free to produce as much milk as it chooses. Milk produced over-quota is sold for export at a price based on actual world prices. According to Canada, that is also the price the producer receives since the returns from over-quota milk are not pooled with higher domestic milk returns.

7.14 Canada further argues that under the Agreement on Agriculture it was required to replace earlier quantitative restrictions on imports of milk with tariffs. Under the former quantitative restrictions regime, Canada had an obligation to also impose domestic restrictions on the production of milk (in accordance with Article XI:2(c)(1) of GATT). Under the new regime, no such domestic restrictions are required. As a result, Canada was free to produce more, including milk for export. According to Canada, the fact that it imposes tariffs leads to higher domestic prices. For exports,

however, lower prices have to prevail in order to compete on world markets. A system of sales at differing prices for domestic and export markets is the consequence. Upholding the complainants' claims would, according to Canada, mean that any such two-tiered system would constitute an export subsidy. This would, according to Canada, in effect mean that a Member imposing tariffs on imports of a product (e.g., milk) can no longer export that product (e.g., milk domestically produced) without being considered to be granting export subsidies.

2. The Panel's decision of 16 December 1998

7.15 We submitted three sets of questions to the parties. The first set was submitted subsequent to our first substantive meeting; the second set after our second substantive meeting; and the third set after receipt of the answers to the second round of questions. We gave ample opportunity to each of the parties to comment on each others' answers.

7.16 After receipt of the US answers to our second set of questions, Canada raised an objection. In a letter dated 8 December 1998, Canada requested us to disregard US Exhibits 56 and 57 – containing data comparing milk prices under Classes 5(d) and (e) to milk equivalent prices under the Import for Re-Export Program (Exhibit 56) and to so-called international prices for milk, butter and skim milk powder (Exhibit 57) – which had been submitted by the United States together with its answers to the second round of Panel questions (in particular, Panel Questions 13 and 14 to the complainants³⁷⁶). Canada made this objection on three grounds. First, Canada argued, these Exhibits contain substantial new factual information that is not required to respond to the Panel's questions. Second, according to Canada, the Exhibits are not relevant to the Panel questions at hand. Third, Canada submitted, the figures have been developed using a highly suspect and very opaque methodology that resulted in some glaring inaccuracies in the numbers. In response, the United States, in a communication dated 14 December 1998, noted that its Exhibits 56 and 57 are directly responsive to the Panel's questions and that, even if the methodology used in these Exhibits were to be flawed, this would not be a basis to disregard the data; at most, the weight to be given to this evidence could be affected.

7.17 Paragraph 7 of our Working Procedures provides as follows:

"Parties shall submit all factual evidence to the panel no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttal submissions or answers to questions. Exceptions to this procedure will be granted upon a showing of good cause. In such cases, the other party shall be accorded a period of time for comment, as appropriate".

In a letter sent to the parties on 16 December 1998 the Panel decided the following:

"First of all the Panel would like to thank the parties for their considered and thorough replies to the Panel's questions, which have helped to clarify both the specific matters in respect of which questions have been raised as well as related issues before the Panel.

³⁷⁶ Question 13 reads: "The Import for Re-Export Program - a) Does the reference to 'products', within brackets, in the last part of Paragraph (d) of the Illustrative List, include 'like or directly competitive products'? - b) Do you consider that skim or whole milk powder are 'like or directly competitive' with fluid industrial milk?". Question 14 reads: "Please comment on Question 18 to Canada below". Question 18 to Canada reads: "If sales of products under special class 5(e) are to be competitive in world markets, the price at which products derived from out of quota milk are made available to exporters will have to be below market prices, in order for the transactions to be commercially viable from the exporters' point of view. Is there a risk or threat of such prices for particular transactions being below world market prices? Please comment in detail on this matter taking into account your replies to question 17 above. New Zealand and the United States are also invited to comment on this matter".

In the Panel's view the data submitted by the United States is both relevant and responsive in the general context in which the Panel's questions were raised, including, in the case of question 13, the competitive relationship between the products in question.

In these circumstances the Panel, whose responsibility or task it is to decide what ultimately is or is not relevant and material in this case, does not consider that it would be appropriate at this stage to exclude from consideration this or any other generally relevant information or data that has been submitted to it.

However, the Panel notes the concerns expressed by Canada regarding the volume and complexity of the data submitted by the United States and in the circumstances extends to Canada an additional week (until 23 December) to provide the Panel with more extensive or additional comments on the United States replies than was possible within the previously established time limits".

3. The Agreements referred to and the sequence in which the Panel will address the claims

(a) The Agreement on Agriculture and the SCM Agreement

7.18 Both complainants invoke the Agreement on Agriculture. Article 2 of this agreement provides that it applies to the agricultural products listed in Annex I. The "agricultural products" set out in Annex I include the products at issue in this dispute (butter, cheese and "other milk products"), all of which fall under HS Chapter 4. We thus find that the Agreement on Agriculture applies to the issue at hand.

7.19 The United States also invokes Article 3 of the SCM Agreement, which contains, *inter alia*, a general prohibition on export subsidies. However, according to its own terms, Article 3 of the SCM Agreement is qualified in its application to agricultural export subsidies by the provisions of the Agreement on Agriculture. Article 3.1 provides as follows:

"Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited ...".

In this respect, Article 21 of the Agreement on Agriculture also provides that:

"[t]he provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement [including the SCM Agreement] shall apply subject to the provisions of this Agreement".

7.20 The general position under the Agreement on Agriculture is that a Member is permitted to use export subsidies but only within the limits of the budgetary outlay and quantity commitment levels, if any, that are specified in that Member's WTO Schedule. The use of agricultural export subsidies beyond such scheduled limits is in effect prohibited by Article 3.3, Article 8 and Article 10 of the Agreement on Agriculture.

7.21 The use of export subsidies beyond such scheduled limits is, in principle, also actionable under the prohibition in Article 3 of the SCM Agreement. However, by virtue of Article 13 (c) (i) of the Agreement on Agriculture, export subsidies that conform fully to Part V of the Agreement on

Agriculture are exempt from actions based on Article 3 of the SCM Agreement for the duration of the "implementation period" (*in casu*, up to 31 December 2003).

7.22 Accordingly, our conclusion with respect to whether the Special Milk Classes Scheme constitutes an export subsidy within the meaning of the Agreement on Agriculture that fully conforms with Part V of that Agreement (which includes Articles 8 to 11 as well as, by reference, Article 3.3), may be dispositive of the US claim for breach of Article 3 of the SCM Agreement.

7.23 On these grounds³⁷⁷, the Panel will first examine the claims made under the Agreement on Agriculture. At the same time we note that the parties do not disagree that the SCM Agreement is important to the contextual interpretation of the provisions of the Agreement on Agriculture dealing with export subsidies. As stated by the Appellate Body in its report on *Brazil – Measures Affecting Desiccated Coconut*:

"[W]ith respect to subsidies on agricultural products ... [t]he *Agreement on Agriculture* and the *SCM Agreement* reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies".³⁷⁸

(b) The Agreement on Agriculture

(i) *General outline*

7.24 As this is the first case brought before a panel which involves the substantive provisions of the Agreement on Agriculture relating to export subsidies, we consider it appropriate to provide an outline of these provisions. They form part of the context within which the specific provisions invoked by the complainants and the related claims must be addressed. They also reflect the object and purpose of the Agreement on Agriculture, another element we need to take into account when examining the issues before us.³⁷⁹

7.25 As enunciated in the preamble to the Agreement on Agriculture, the main purpose of the Agreement is to "establish a basis for initiating a process of reform of trade in agriculture"³⁸⁰ in line with, *inter alia*, the long-term objective of establishing "a fair and market-oriented agricultural trading system".³⁸¹ This objective is pursued in order "to provide for substantial progressive reductions in agricultural support and protection sustained over an agreed period of time, resulting in correcting and preventing restrictions and distortions in world agricultural markets".³⁸²

7.26 The general aim of the Uruguay Round negotiations on agriculture was to "achieve greater liberalisation of trade in agriculture and bring all measures affecting import access and export competition under strengthened and more operationally effective GATT rules and disciplines".³⁸³ In the case of export competition this was to be achieved by "improving the competitive environment by increasing discipline on the use of all direct and indirect subsidies and other measures affecting directly or indirectly agricultural trade, including the phased reduction of their negative effects and

³⁷⁷ See paras. 7.19-7.22.

³⁷⁸ Appellate Body Report on *Brazil – Desiccated Coconut*, *op. cit.*, p. 14.

³⁷⁹ In accordance with the principles of treaty interpretation contained in the Vienna Convention on the Law of Treaties (Article 31).

³⁸⁰ Preambular paragraph 1.

³⁸¹ Preambular paragraph 2.

³⁸² Preambular paragraph 3.

³⁸³ Punta del Este Declaration, Ministerial Declaration on the Uruguay Round, MIN.DEC, 20 September 1986, p. 6.

dealing with their causes".³⁸⁴ The results of these negotiations take the form of: (i) the specific binding reduction commitments on both export subsidies and domestic support which have been incorporated in Members' Schedules pursuant to Article 3.1 of the Agreement on Agriculture as constituting "commitments limiting subsidization"; and (ii) the rules set out in the Agreement on Agriculture itself, which are designed to protect the scheduled commitments and provide a new framework to govern the use of agricultural export subsidies and domestic support.

7.27 The fundamental general provision of the Agreement on Agriculture concerning export subsidies is Article 8:

"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule".

Article 1(e) of the Agreement defines the term "export subsidies" ("unless the context otherwise requires") as referring to: "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". This listing of export subsidies and the related base period for subsidised export quantities and budgetary outlays served as the basis for the establishment of the scheduled Uruguay Round reduction commitments. Under Article 9.1 the following export subsidies are subject to reduction commitments under the Agreement:

- "(a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance;
- (b) the sale or disposal for export by governments or their agencies of non-commercial stocks of agricultural products at a price lower than the comparable price charged for the like product to buyers in the domestic market;
- (c) payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived;
- (d) the provision of subsidies to reduce the costs of marketing exports of agricultural products (other than widely available export promotion and advisory services) including handling, upgrading and other processing costs, and the costs of international transport and freight;
- (e) internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments;
- (f) subsidies on agricultural products contingent on their incorporation in exported products".

³⁸⁴ *Ibid.*

7.28 By virtue of Article 3.3 of the Agreement, the list in Article 9.1 lays the foundation for the core rules of the Agreement relating to export subsidies. Article 3.3 provides:

"Subject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule".

7.29 The Article 3.3 prohibition relates exclusively to the export subsidies listed in Article 9.1. All other subsidies contingent upon export performance as defined in Article 1(e) of the Agreement are subject to the provisions of Article 10 relating to the prevention of circumvention of export subsidy commitments. 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".

Thus, a Member may use export subsidies not listed in Article 9.1 within the limits of its scheduled reduction commitments. However, as stipulated by Article 10.1, such subsidies may not be applied so as to circumvent these and other export subsidy commitments under the Agreement on Agriculture.

(ii) *The specific provisions relied upon by the parties*

7.30 Both complainants invoke Articles 3.3, 8, 9.1 and 10 of the Agreement on Agriculture, quoted above.

7.31 Since Article 9.1 sets out the explicit reduction commitments entered into by Canada, as opposed to Article 10 which deals with circumvention of those commitments, we shall first examine whether the Special Milk Classes Scheme involves an export subsidy listed in Article 9.1. Both complainants also first address Article 9.1. We prefer this sequence to Canada's approach of first examining whether the scheme is a "subsidy" more generally with particular reference to the SCM Agreement. What needs to be examined here in the first place is whether an "export subsidy" is provided for quantities of exports of agricultural products in excess of the reduction commitments made by Canada under the Agreement on Agriculture. In our view, the most specific and appropriate language provided to make this determination is found in Article 9.1 of the Agreement on Agriculture - setting out specific practices as "export subsidies" explicitly made subject to Canada's reduction commitments -; not in Article 1 of the SCM Agreement pursuant to which certain practices are deemed to be a "subsidy" for purposes of the SCM Agreement.

4. Burden of proof as a consequence of Article 10.3 of the Agreement on Agriculture

7.32 We note, prior to our analysis of Article 9.1, that Article 10.3 provides as follows:

"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".

7.33 This provision shifts the burden of proof from the complainant to the defendant. A defending party (i.e., the exporting country) alleging that exports in excess of its reduction commitment level are not subsidized must demonstrate that no export subsidy in respect of this excess has been granted. All parties in dispute agree that the wording of Article 10.3 has this effect of reversing the usual burden of proof.³⁸⁵

7.34 In this dispute, all parties agree that the actual exports of butter, cheese and "other milk products" made by Canada, exceed Canada's reduction commitment levels and this for both marketing years at issue (1995/1996 and 1996/1997).³⁸⁶ Canada claims that these quantities exported in excess of its reduction commitment levels are *not* subsidized. It is thus for Canada to establish that the quantity of exports exceeding its commitment levels has *not* been made subject to "export subsidies". In other words, for purposes of the claims before us, it is for Canada to present evidence sufficient to establish a presumption that the Special Milk Classes Scheme does *not* involve an "export subsidy, whether listed in Article 9 or not". Once such presumption is established, it is for New Zealand and the United States to present evidence to rebut this presumption.³⁸⁷ New Zealand and the United States responded *in extenso* to the claim that the export quantities in question are not subject to export subsidies. Thus, our task is essentially to weigh the evidence and determine whether Canada has met the burden imposed by Article 10.3.

5. Article 9.1(a) of the Agreement on Agriculture

7.35 The complainants rely on Article 9.1(a) and (c). Both provisions define a type of export subsidy that is subject to Canada's reduction commitments. The parties do not disagree that there may be some degree of overlap between various sub-paragraphs of Article 9.1. The complainants submit that the provision of milk under Classes 5(d) and (e) of the Special Milk Classes Scheme involves export subsidies under both Article 9.1(a) and Article 9.1(c).

7.36 We first examine whether there is an Article 9.1(a) export subsidy at issue. Article 9.1(a) subjects the following type of action to Canada's export subsidy reduction commitments:

"the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance".

7.37 The complainants submit that in this case Canadian government agencies – in particular, the Canadian Dairy Commission ("the CDC") and the provincial milk marketing boards acting under delegated authority – make milk available to processors/exporters under Classes 5(d) and (e) at prices lower than the prevailing domestic milk price. In their view, this constitutes an export subsidy under Article 9.1(a).

7.38 Under Article 9.1(a), an export subsidy exists if the following conditions are fulfilled:

- (a) the presence of "direct subsidies, including payments-in-kind";
- (b) provided "by governments or their agencies";

³⁸⁵ See, in particular, Canada's answer to Panel Question 14 to Canada.

³⁸⁶ See Table 2 in para. 2.41 above.

³⁸⁷ See Appellate Body report on *United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, adopted on 23 May 1997, WT/DS33/AB/R, pp. 13-14.

- (c) "to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board"; and
- (d) which are "contingent on export performance".

7.39 The record shows that milk is made available to *processors/exporters* under Classes 5(d) and (e). We consider that Article 9.1(a) applies to processors and exporters as either "a firm", "an industry" or "producers of agricultural products". We note that no party argued that producers or exporters were to be excluded from the application of Article 9.1(a). We thus find that the third condition under Article 9.1(a) is met in the instant case.

7.40 The record also shows, and Canada does not argue otherwise, that lower priced milk under Classes 5(d) and (e) is only available to processors for the processing of *dairy products which will be exported*. Accordingly, access to milk at a discounted price under Classes 5(d) and (e) is "contingent on export performance" in the sense of the fourth condition under Article 9.1(a). Milk for the production of *dairy products to be sold on the Canadian market* is only available at a higher price under one of the other milk classes (Classes 1 to 5, excluding 5(d) and (e)). A processor that buys milk under Classes (d) or (e), but subsequently uses the milk for domestic purposes, has to pay the price differential up to the level of the domestic milk price, plus interest calculated on the price differential starting from the time of transaction to the date of payment.³⁸⁸

7.41 The United States also makes claims under milk classes other than Classes 5(d) and (e). In this regard, we note that milk under such other classes is also available (often exclusively) to processors which produce for the domestic market. Accordingly, access to milk under such other classes is not "contingent on export performance". We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a).

7.42 The question is then whether the availability of milk under Classes 5(d) and (e) also meets the first and second conditions of Article 9.1(a): (i) does it provide "direct subsidies, including payments-in-kind"; and (ii) are such direct subsidies provided "by governments or their agencies"?

(a) "direct subsidies, including payments-in-kind"

(i) *General criteria*

7.43 The plain language of Article 9.1(a) makes clear that "payments-in-kind" are a form of direct subsidy. Hence, a determination in the instant matter that "payments-in-kind" exist would also be a determination of the existence of a direct subsidy.

7.44 We first note that, when referring to subsidies (as Article 9.1(a) does), the ordinary meaning of the term "payment" cannot reasonably relate to a "payment" as the term is understood in contract law (e.g., pay for labour or the price of a good). Rather, it connotes a gratuitous act, a bounty or benefit provided, for example, in pursuit of a policy objective (e.g., in the area of export subsidies, the stimulation of exports to dispose of surpluses in the domestic market). A reading of Article 9.1(a) to the effect that a "payment" exists only if a benefit is granted, is further mandated by the general

³⁸⁸ See Canada's answer to Panel Question 23 to Canada. In Quebec, the processor will also have to pay a penalty of \$12/hL.

context of this provision which includes Article 1 of the SCM Agreement.³⁸⁹ That provision explicitly requires that a "benefit" be conferred for there to be a "subsidy" under the SCM Agreement.³⁹⁰

7.45 Secondly, the term "payments-in-kind" in Article 9.1(a) must be ordinarily construed to include payment in goods or labour as opposed to payment of money.³⁹¹ We agree with the complainants that both the provision of a good at no price and the provision of a good at a price lower than the normal price (whatever this normal price may be) can be considered as a payment in kind.

(ii) *Milk sales under Special Milk Classes 5(d) and (e): the provision of milk for the processing of dairy products for export at a lower price*

7.46 In the present case, no money is given gratuitously to processors/exporters. However, the complainants submit that under the Special Milk Classes Scheme processors/exporters receive a payment in kind, namely *milk at a price which is lower than that of milk sold for use on the domestic market*.

7.47 We noted above that a benefit must be conferred for a payment in kind to exist in the sense of Article 9.1(a).³⁹² In this case, the question thus arises whether the provision of milk to processors/exporters under Classes 5(d) or (e) confers a benefit to these processors/exporters. This, in turn, raises the question of what the appropriate benchmark is for determining whether the provision of a good at a certain price confers a benefit.³⁹³ Does it suffice, as the complainants argue, that milk for export use is provided to processors at a price below the *domestic milk price* for there to be a benefit conferred to these processors (hereafter referred to as "the first benchmark", namely the domestic milk price)? Or, does one need to establish that processors/exporters receive milk under Classes 5(d) and (e) at a price which is not only lower than the domestic milk price, but also lower than the price of milk these processors/exporters can obtain from any other source, in particular the price of milk they can source from the world market (hereafter referred to as "the second benchmark", namely the lowest milk price to be obtained from any other source)?

7.48 If milk were provided below the lowest milk price to be obtained from any other source (i.e., below the second benchmark), it would *a fortiori* be provided below the domestic milk price (i.e., below the first benchmark). In other words, if we were to find that milk is provided below the second benchmark, there would be no need to further examine whether it is also provided below the first benchmark. Without making a finding on the issue of the appropriate benchmark we shall, therefore, in the first instance, proceed on the assumption that the second benchmark, although more favourable to Canada, is appropriate in the circumstances. In our view, if the price of milk under Classes 5(d) and (e) is lower than the price at which processors/exporters can obtain milk from any other source, a bounty or benefit – i.e., something they would otherwise not have obtained – would, indeed, be conferred. If this were the case, we consider that processors/exporters would be receiving "payments-in-kind" in the sense of Article 9.1(a).

7.49 We therefore next examine whether processors/exporters can access milk from any other source on terms and conditions, in particular prices, as favourable as those offered under Classes 5(d) and (e).

³⁸⁹ See para. 7.23.

³⁹⁰ Article 1.1(b) of the SCM Agreement provides: "For the purpose of this Agreement, a subsidy shall be deemed to exist if: ... (b) a benefit is thereby conferred".

³⁹¹ The *New Shorter Oxford English Dictionary* defines "in kind" as "in goods or labour as opp. to money; (b) in a similar form, likewise" (Ed. Brown, L., Clarendon Press, Oxford, Volume 1, p. 1489).

³⁹² See para. 7.44.

³⁹³ We note, in this respect, that Article 1.1(b) of the SCM Agreement – to which we referred when noting the requirement of a "benefit" being conferred in paragraph 7.44 above – only requires that there be a benefit in the general sense and that the benefit in fact be conferred by the measure or arrangement which is alleged to be a subsidy.

7.50 We note, first, that under Classes 5(d) and (e) milk is made available to processors for export at a significantly lower price than the price of milk *for domestic use*.³⁹⁴ Canada does not contest this. Classes 5(d) and (e) thus make available milk at prices that are clearly below the first benchmark we referred to above.³⁹⁵ Moreover, referring to the second benchmark, it is not disputed that sourcing milk from any of the other milk classes for use mainly on the domestic market (Classes 1 to 5(c)) would not offer processors/exporters the same favourable price as that of milk available under Classes 5(d) or (e).³⁹⁶

7.51 Second, given the high tariffs applied by Canada to imports of fluid milk³⁹⁷ (283.8 per cent, declining to 241.3 per cent in 2001), the price of milk under Classes 5(d) and (e) is not only significantly lower than the domestic milk price, it is also significantly lower than the duty paid price of imported fluid milk. Canada does not dispute this nor does it contest that for all intents and purposes the over-quota tariff rate it imposes on imports of fluid milk effectively precludes such imports. For purposes of the second benchmark, importing fluid milk cannot therefore be considered as a source of milk at the same favourable price as that of milk offered under Classes 5(d) or (e).

7.52 Canada submits that processors for export can access their milk inputs on equally favourable terms and conditions as those under Classes 5(d) and (e) under its special Import for Re-Export Program.³⁹⁸ With respect to imports of fluid milk under this Program Canada acknowledges that "there have not been imports of raw industrial milk in recent years under the Import for Re-Export Program".³⁹⁹ Canada argues, however, that under the Import for Re-Export Program processors/exporters can nonetheless import milk derivatives, such as skim milk powder, whole milk powder, butter and butter derivatives. According to Canada, these milk components are not different from milk, but part of the same product and can be used for the same manufacturing processes as milk.

7.53 We note that under the Import for Re-Export Program the decision as to whether fluid milk or milk derivatives may enter the Canadian market depends, first and foremost, on the discretionary authority of the Department of Foreign Affairs and International Trade. The statutory authority for the Program is contained in paragraph 8 of the Export and Import Permits Act. Paragraph 8 (1) allows the Minister responsible for the Act to "issue to any resident of Canada applying therefor a permit to import goods included in an Import Control List, in such quantity and of such quality, by such persons, from such places or persons and *subject to such other terms and conditions as are described in the permit or in the regulations*".⁴⁰⁰ Canada states that the authority of the Minister to set these terms and conditions is not subject to any specified regulations. Therefore - even if imports of fluid milk and milk derivatives under the Import for Re-Export Program could in theory be made at an equally favourable price to the one offered under Classes 5(d) and (e) - the fact that the Minister has to issue a permit before such imports are allowed and that the Minister disposes of a wide discretion in doing so, is proof that these imports are not effectively available under equally favourable terms and conditions as those offered under Classes 5(d) and (e). After all, whether or not processors for export access fluid milk or milk derivatives under this Program depends, in the first place, not on commercial considerations (i.e., price), but on the discretion of Canadian authorities.

³⁹⁴ See Table 3 in para. 2.51.

³⁹⁵ See para. 7.47.

³⁹⁶ See Table 3 in para. 2.51.

³⁹⁷ Other than the fluid milk falling under the 64,500 tonnes tariff-rate quota which Canada restricts to cross border imports by Canadians of consumer packaged milk for personal use, valued at less than C\$20 per entry.

³⁹⁸ See para. 2.11.

³⁹⁹ Canada's oral statement at the second substantive meeting, para. 74. In its comments on US Exhibit 56, Canada clarified that "much of the fluid milk imported under the Import for Re-export Program is imported in retail packages for use on cruise ships".

⁴⁰⁰ Emphasis added.

7.54 We further note that processors for export have so far never accessed *fluid milk* for commercial use under this Program.⁴⁰¹ Canada argues that no such imports of fluid milk are made due to commercial reasons, namely, the high costs of transport of fluid milk. Canada also refers to the fact that fluid milk is of a perishable nature and thus of limited tradability. We note, however, that fluid milk could be imported from the United States (given its proximity to Canada). In view of the US claim before this Panel to have wider access to the Canadian market for fluid milk (under Canada's tariff-rate quota)⁴⁰², one can assume that imports of fluid milk are, in principle, technically and commercially viable. Nonetheless, under the Import for Re-Export Program no such imports are made. In our view, this indicates that the specific sales terms and conditions under the Program are clearly not commercially attractive relative to those offered under Classes 5(d) or (e).

7.55 In addition, with respect to access to *milk derivatives* under the Import for Re-Export Program, we note the Complainants' arguments that there are inherent differences between fluid milk - available under Classes 5(d) and (e) - and milk derivatives which can be imported under the Program. Skim milk powder, for example, does not contain any butterfat, thus requiring additional processing for its use in certain dairy products. Because fluid milk contains butterfat it is not subject to a similar constraint. Whole milk powder, on the other hand, does contain butterfat but since all liquid has been removed from it, for most end-uses it has to be rehydrated before it can be used. The same constraint applies to skim milk powder, but not to fluid milk. In both instances, additional time and cost are involved when using milk powder as an input rather than fluid milk. The United States further submits that the use of milk powder might also alter the flavour of the finished product from that which would be obtained by using fluid milk. Canada seems to acknowledge some of these elements when it states that "milk powders can be reconstituted for use in the manufacture of *some* dairy products ... Thus, *to a certain extent*, milk powders compete in the same markets and fulfil the same needs and uses as fluid industrial milk".⁴⁰³

7.56 In our view, even if such milk derivatives were directly competitive with fluid milk, we note that (i) figures submitted by the United States indicate – albeit in general terms only - that the milk equivalent prices for the milk derivatives imported under the Import for Re-Export Program were, over the last four years, *higher* than the price of fluid milk provided under Classes 5(d) and (e)⁴⁰⁴; and (ii) processors for export have revealed an overwhelming preference for Classes 5(d) and (e) milk, as opposed to sourcing inputs from the Program (exports generated with Classes 5(d) and (e) milk account for approximately 95 per cent of total actual exports).⁴⁰⁵ Indeed, in our view, the fact that fluid milk and milk derivatives surplus to Canadian domestic requirements are regularly disposed of (without accumulation of stocks) raises a presumption that the terms and conditions available under Classes 5(d) and (e) are more favourable than those under the Import for Re-Export Program. The elements outlined above indicate that milk derivatives cannot, for all practical purposes, be sourced under the Program on equally favourable terms and conditions as those under Classes 5(d) or (e).

7.57 For the above reasons⁴⁰⁶, we find that Canada, in relation to Classes 5(d) and (e), has *not* met its burden⁴⁰⁷ of establishing that the Import for Re-Export Program provides processors for export with

⁴⁰¹ See para. 7.52 and footnote 399.

⁴⁰² See paras. 7.142 ff.

⁴⁰³ Canada's answer to Panel Question 28(f) to Canada, emphasis added.

⁴⁰⁴ See US Exhibit 56. In our decision of 16 December 1998, outlined above in para. 7.17, we decided that we can take cognizance of the figures contained in this Exhibit. We carefully considered Canada's objections to these figures set out in Canada's comments of 23 December 1998. Although these figures seem to include certain inaccuracies and can therefore only provide a general indication, we do not consider that Canada's objections are so serious that no weight at all should be attached to Exhibit 56. We note, moreover, that Canada did not provide figures or indications to effectively rebut the general tendency shown by the US figures. Moreover, in the view of the Panel, the fact that some of the data supplied by Canada on exports under the Import for Re-Export Program related to imports and re-exports of dairy products by visiting cruise ships, casts doubt on the relevance of this data and of the Program itself.

⁴⁰⁵ See Canada's answers to Panel Questions 1 and 3(b) to Canada.

⁴⁰⁶ See paras. 7.52-7.56.

access to milk - or even milk derivatives for that matter - on equally favourable terms and conditions as those available under Classes 5(d) or (e).

7.58 More generally - and for all the reasons outlined above⁴⁰⁸ - we find that the provision of milk to processors/exporters under Classes 5(d) and (e) at a price significantly lower than the domestic milk price (i.e., below the first benchmark) and on terms and conditions which are more favourable than those under any other alternative source, including under the Import for Re-Export Program (i.e., below the second benchmark) – confers a "benefit" (in terms of both the first and second benchmarks we set out earlier⁴⁰⁹) to these processors/exporters and, for that reason, constitutes a payment in kind – namely, the provision of a good at a discounted price - in the sense of Article 9.1(a).

(iii) *Milk sales under Special Milk Classes 5(d) and (e): the provision of milk for the processing of dairy products for export by the CDC with an assured margin for the processor*

7.59 In addition to milk being offered at a discounted price otherwise not available, we note that with respect to the export sales conducted by the CDC itself – for which the CDC engages a processor to make dairy products with milk sourced under Classes 5(d) or (e) - there is another element which indicates that processors for export receive special treatment (i.e., a benefit) under Classes 5(d) and (e) which is otherwise not granted on commercial grounds. That is, no matter how low the world price is for the dairy product that a processor is requested to produce - and thus no matter how low the milk price should be in order for the processor to be able to produce the dairy product at such a low price - a Canadian processor for export is always sure to obtain a certain "margin".⁴¹⁰ This processor "margin" covers the cost of transforming milk into, e.g., butter or skim milk powder, and a return on investment for the processors.⁴¹¹ This margin ensures that, in respect of exports by the CDC, processors are able to access milk at a price which enables the CDC to sell the processed dairy products on the world market at a competitive price. But for the Special Milk Classes Scheme, this guarantee offered to processors/exporters would not be commercially available.

7.60 In our view, this assured processor margin for certain exports generated with milk sourced under Classes 5(d) and (e) confirms the finding we made in paragraph 7.58, namely that the provision of milk to processors/exporters under Classes 5(d) and (e) on the reported favourable terms and conditions confers a benefit to these processors/exporters and, for that reason, constitutes a payment in kind in the sense of Article 9.1(a).

(iv) *Concluding remarks on the payment in kind offered to processors/exporters*

7.61 But for Classes 5(d) and (e), processors for export under the current Canadian milk regime would have to pay a significantly higher price for milk. By accessing this milk, these processors/exporters are effectively shielded from the high domestic milk price, the high import tariffs on fluid milk and – at least in respect of those exports made by the CDC itself - the risk of having to sell dairy products for sale on the world market at a reduced margin or at a loss.

7.62 We want to stress, however, that the existence of this "payment in kind" to processors does not in and of itself establish the existence of an export subsidy within the meaning of Article 9.1(a). In our

⁴⁰⁷ See para. 7.34.

⁴⁰⁸ See paras. 7.53-7.56.

⁴⁰⁹ See para. 7.47.

⁴¹⁰ See Section 1 (vii) and 2 (v) of Annex B to the Comprehensive Agreement on Special Class Pooling stating, respectively, "the processor will receive a reduced margin" and "[p]rocessors will receive full margin for the product sold".

⁴¹¹ See Canadian International Trade Tribunal, Profile of the Canadian Dairy Industry, Staff Report, reference No. GC-97-001, New Zealand Exhibit 8, p. 36.

view, in particular the existence of parallel markets for domestic use and for export with different prices does not necessarily constitute an export subsidy.⁴¹² Whether or not the "payments-in-kind" to processors in this dispute constitute an export subsidy depends on the government's involvement in providing it.⁴¹³ This relates to the second condition under Article 9.1(a).

(b) provided "by governments or their agencies"

7.63 Under this condition, we need to examine whether the milk made available to processors for export at a discounted price under Classes 5(d) and (e) – which we found earlier to constitute a payment in kind – is provided by the Canadian governments or their agencies.

(i) *The provision of milk under Classes 5(d) and (e) is not financed by governmental funds but by milk producers either collectively (in-quota) or individually (over-quota)*

7.64 All parties agree that under Classes 5(d) and (e) no governmental funds are directly involved.⁴¹⁴ Neither the Canadian government nor its agencies buy milk at the high domestic price to sell it subsequently, at a loss, at a lower price for export, whereby the cost would be covered by governmental funds. It is undisputed that only the milk producers finance the sales of milk for export. For milk produced within a producer's quota and subsequently exported, the price differential between the price for export and the higher domestic price is collectively borne by all Canadian milk producers. This is so because all in-quota export revenues are pooled with all other in-quota milk returns. This pooling results in an average or pooled milk price – lower than the domestic price - which is the same for all in-quota milk produced by a given producer. Any milk produced over-quota necessarily obtains the lower price for export. However, in principle, only the individual producer who produces the over-quota milk bears the cost of such lower returns. This is so because returns of over-quota milk by one producer are generally not pooled with in-quota returns obtained by other producers.⁴¹⁵

7.65 In our view, the fact that the government does not grant governmental funds to *finance* the payment in kind does not prevent this payment in kind from being *provided* by the government or its agencies in the sense of Article 9.1(a). The ordinary meaning of the word "provide" is not restricted to a financial contribution. The dictionary meaning of the word "provide" is rather:

⁴¹² The price differential may, for example, be a consequence of high – but WTO consistent - import tariffs that can cause domestic prices to be higher than the world market price. In such scenario, efficient producers may take the decision – based on their own profitability - to also produce and sell milk for export, albeit at a lower price than the domestic price. If the decision to sell in either the domestic market or the export market is one made by the individual producer and based on commercial grounds only (e.g., on an allocation of sales to the two markets with a view to obtaining a maximised total revenue, taking into account the inherently limited domestic demand for milk and the lower price for export) - not a decision by the government or its agencies taken on behalf of the producers - such scenario would, in our view, not appear to be an export subsidy in the sense of Article 9.1.

⁴¹³ In this respect, we note the Panel Report on *Review Pursuant to Article XVI:5* (of GATT 1947), addressing the question of when subsidies are notifiable under Article XVI of GATT. There, the Panel stated the following:

"The Panel examined the question whether subsidies financed by a non-governmental levy were notifiable under Article XVI. The GATT does not concern itself with such action by private persons acting independently of their governments except insofar as it allows importing countries to take action under other provisions of the Agreement. In general terms there was no obligation to notify schemes in which a group of producers voluntarily taxed themselves in order to subsidize exports of a product ... the Panel feels that the question of notifying levy/subsidy arrangements depends upon the source of the funds and the extent of government action, if any, in their collection. Therefore ... the Panel feels that CONTRACTING PARTIES should ask governments to notify all levy/subsidy schemes affecting imports or exports which are dependent for their enforcement on some form of government action" (adopted 24 May 1960, BISD9/188, p. 192).

⁴¹⁴ In any event, the complainants did not contest the extent to which the full costs associated with the administration of the scheme for exporting milk surplus to Canadian domestic requirements, are effectively recovered by the CDC and the provincial governments or agencies.

⁴¹⁵ See, however, para. 7.112.

"1. foresee. 2. take appropriate measures in view of a possible event; make adequate preparation ... 4. prepare, get ready, or arrange (something beforehand) 5. equip or fit out with what is necessary for a certain purpose; furnish or supply with something 6. ... make available; yield, afford".⁴¹⁶

(ii) *The degree of government involvement required for there to be a "provision by governments or their agencies" under Article 9.1(a)*

7.66 Canada does not argue that governments are not involved in providing milk under Classes 5(d) and (e). Rather, its position is that governments only have an implementing and oversight role to play in the establishment and efficient operation of the system. According to Canada, such government intervention does not approach the level required by Article 9.1(a). The complainants contend that the system would not exist without governmental intervention and that none of the provisions at issue requires that governments dictate every aspect of a measure for an export subsidy to exist. The complainants conclude that in this case the government involvement in the Special Milk Classes Scheme does meet the level required by Article 9.1(a).

7.67 The question of government involvement required under Article 9.1(a) is one of degree that must be addressed on a case-by-case basis. In this dispute, we need to examine first how milk is made available under Classes 5(d) and (e). Thereafter, we need to assess the extent to which Canadian governments or their agencies are involved in this process. On that basis – and applying the ordinary meaning of the term "provision by governments or their agencies" referred to above⁴¹⁷, in its context and in light of the object and purpose of the Agreement on Agriculture⁴¹⁸ - we will then decide whether or not the payment in kind made under Classes 5(d) and (e) can be said to be provided by Canada's governments or their agencies.

(iii) *How milk for export is made available under Classes 5(d) and (e)*

Sales of milk for export under Class 5(d)

7.68 Class 5(d) covers so-called "traditional" export sales. These traditional sales – which are calculated into the national quota and thus constitute in-quota milk - are linked to certain trade opportunities, such as tariff-rate quotas of third countries that are traditionally made available to Canadian exporters, as well as sales arising out of longer term trading relationships. The volume of Class 5(d) is a set amount annually fixed by the Canadian Milk Supply Management Committee ("the CMSMC").

7.69 Exporters with access to these traditional markets approach the Canadian Dairy Commission ("the CDC") with proposals to purchase milk under Class 5(d). The CDC negotiates the transaction, including the milk price, and issues a permit which will allow the exporter to obtain the required milk for use in the planned exports from one of the provincial marketing boards. The permits issued by the CDC under Class 5(d) specify the dairy products to be exported.

Sales of milk for export under Class 5(e)

7.70 Both in-quota milk – mainly the so-called "sleeve" or safety margin which is finally not used in domestic markets⁴¹⁹ - and over-quota milk can be exported under Class 5(e). The removal of

⁴¹⁶ The *New Shorter Oxford English Dictionary*, Ed. Brown, L., Clarendon Press, Oxford, Volume 2, p. 2392.

⁴¹⁷ See para. 7.65.

⁴¹⁸ See paras. 7.24 ff.

⁴¹⁹ See para. 2.40.

surplus milk by means of exports under Class 5(e) is composed of two operational elements: a CDC-initiated and a processor-initiated surplus removal element.

7.71 A first possibility is that the CDC itself initiates "preemptive surplus removal". In doing so, it "will be guided by an advisory group established by the CDC for that purpose".⁴²⁰ This advisory group, the Surplus Removal Committee ("SRC"), decides whether surplus milk is available in the system. If so, the CDC can activate the preemptive surplus removal program. To do so, the CDC does not have to seek further agreement from the provincial marketing boards that milk surplus to domestic requirements is available. If the CDC decides to activate the program, it will actively remove surplus by contracting with processors for the manufacture of products suitable for export. At this stage, two possibilities arise: either (i) the CDC, acting in its own right, purchases the dairy products and exports them through transactions it negotiates with state importers in other countries, or (ii) the CDC issues permits to processors which will allow these processors to buy milk under Class 5(e) from one of the provincial marketing boards, whereafter these processors themselves, or through traders, export the dairy products produced. The permits issued by the CDC under Class 5(e) specify the dairy products to be exported. In both instances, it is the CDC which negotiates the milk price with the processor. In the event of exports by the CDC itself, it is also the CDC which negotiates and grants the processor margin.⁴²¹

7.72 A second possibility arises during the period in which the CDC initiated surplus removal program is inactive. In these circumstances, "access to CDC contracts to dispose of surpluses will be available when requested by individual processors".⁴²² In practice, a processor wanting to produce for export first negotiates the terms of a potential sale of dairy products with a foreign buyer. The processor then needs to access milk, in order to produce the dairy product, at a price which will allow it to make the transaction. To do so, the processor has to obtain a permit from the CDC, allowing it to buy milk under Class 5(e). This permit also specifies the dairy products to be exported. The CDC can only issue such permit "when all demand for milk by processors in the province in harmonized Classes 1 to 5(d) is met". It is the CDC which negotiates the milk price with the processor. Once the processor obtains a Class 5(e) permit from the CDC, it approaches the local marketing board which in practice provides the processor with the milk at the negotiated price. Under this second possibility, the CDC itself can also buy the processed dairy products – produced with Class 5(e) milk - and export them in its own right. In that event, processors receive "full margin for product sold", a margin negotiated and granted by the CDC.⁴²³

(iv) *The extent to which Canada's governments or their agencies are involved in the making available of milk under Classes 5(d) and (e)*

Canada's governments and their agencies

7.73 Canada is a federal state with a federal government and ten provincial governments. Regulatory jurisdiction over trade in dairy products is divided between the federal government and the provinces. The federal government has constitutional authority over interprovincial and international trade. All other aspects of production and sale of milk are under provincial jurisdiction. Both the Canadian federal government and provincial governments are "governments" for the purposes of Article 9.1(a).⁴²⁴

⁴²⁰ Section 1(i) of Annex B to the Comprehensive Agreement on Special Class Pooling.

⁴²¹ Section 1 (vii) of Annex B to the Comprehensive Agreement on Special Class Pooling.

⁴²² Section 2 (i) of Annex B to the Comprehensive Agreement on Special Class Pooling.

⁴²³ Section 2 (v) of Annex B to the Comprehensive Agreement on Special Class Pooling.

⁴²⁴ Article XXIV:12 of GATT 1994, part of the context of Article 9.1(a), provides as follows: "Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local

7.74 Three bodies play a direct decision-making role under Classes 5(d) and (e): the CDC, the provincial marketing boards and the CMSMC.

7.75 First, the CDC is a Canadian Crown Corporation. That the CDC is an "agency" of Canada's federal government in the sense of Article 9.1(a) is undisputed.⁴²⁵

7.76 Second, the provincial milk marketing boards are established and operate within a legal framework set up by federal and provincial legislation.⁴²⁶ These boards exercise powers in respect of inter-provincial and external trade delegated to them by the federal government through the CDC, as well as powers delegated to them by provincial authorities. Three of these boards (Alberta, Nova Scotia and Saskatchewan) are, according to Canada, agencies of the provincial government. Orders or regulations issued by the provincial marketing boards can be enforced before the Canadian courts. In most provinces, individual decisions by the boards are subject to appeal to a provincial supervisory board or commission (of which Canada recognizes the governmental nature).

7.77 While we acknowledge that producers play an important role in the provincial marketing boards, we also note that these boards act under the explicit authority delegated to them by either the federal or a provincial government. Accordingly, they can be presumed to be an "agency" of one or more of Canada's governments in the sense of Article 9.1(a).⁴²⁷ In this respect, we refer to paragraph 2 of the *Ad* note to Article XVII:1 of GATT 1994⁴²⁸ as well as to Article XXIV:12 of GATT 1994⁴²⁹, both constituting part of the context of Article 9.1(a). That the provincial marketing boards cannot issue orders or regulations without the backing of provincial or federal authority was confirmed by the Canadian courts in the so-called *Bari II* case.⁴³⁰ In that case, it was found that the

governments and authorities within its territory". The Understanding on the Interpretation of Article XXIV of GATT 1994, under Article XXIV:12, explicitly provides that "[t]he provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding may be invoked in respect of measures affecting its observance taken by regional or local governments or authorities within the territory of a Member". These provisions imply that all GATT provisions apply to "regional and local governments and authorities" within a WTO Member, in accordance with the general principle of public international law that a party to a treaty "may not invoke the provisions of its internal law as justification for its failure to perform a treaty" (set out in Article 27 of the Vienna Convention on the Law of Treaties). Article XXIV may act to limit the obligation of a WTO Member, which is a federal State, to secure the implementation of its GATT obligations. However, in our view, it does not limit the applicability of the provisions of GATT 1994 (see Panel Reports on *Canada – Measures Affecting the Sale of Gold Coins*, L/5863, unadopted, dated 17 September 1985, paras. 53-54 and 63-64; *Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*, adopted on 22 March 1988, 35S/37, p. 91, para. 4.33; and *Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, adopted on 18 February 1992, 39S/27, p. 86, para. 5.35).

⁴²⁵ See paras. 2.12-2.15.

⁴²⁶ See paras. 2.16-2.20.

⁴²⁷ In this respect, we refer to Article 7:2 of the Draft Articles on State Responsibility of the International Law Commission (ILC) - which might be considered as reflecting customary international law - which states: "The conduct of an organ of an entity which is not part of the formal structure of the State or of a territorial governmental entity, but which is empowered by the internal law of that State to exercise elements of the governmental authority, shall also be considered as an act of the State under international law, provided that organ was acting in that capacity in the case in question" (Report of the ILC on the Work of its 48th Session, General Assembly, Official Records, 51st Session, Supplement No. 1 (A/51/10), under Chapter III).

⁴²⁸ Paragraph 2 of the *Ad* note to Article XVII:1 of GATT 1994 states: "The activities of Marketing Boards which are established by contracting parties and which do not purchase or sell but lay down regulations covering private trade are governed by the relevant Articles of this Agreement". Since, accordingly, GATT 1994 applies to such activities of "marketing boards" - and the Canadian provincial milk marketing boards are, in our view, such "marketing boards" - one can assume that most of the activities of the Canadian milk marketing boards are governmental in nature.

⁴²⁹ Provincial marketing boards acting under the authority explicitly delegated to them by federal or provincial governments are, in our view, "regional" or "local" authorities in the sense of Article XXIV:12 of GATT 1994, outlined above in footnote 424. See, in this respect, the 1988 Panel Report on *Canada – Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies*: "The panel noted that there was no dispute that the provincial liquor boards were 'regional authorities' within the meaning of Article XXIV:12" (adopted on 22 March 1988, 35S/37, p. 91, para. 4.33) and the 1992 Panel Report on *Canada – Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*: "The Panel noted that the parties to the dispute agreed that the provincial liquor boards were 'regional authorities' within the meaning of Article XXIV:12 of the General Agreement and that this Article was therefore applicable to all provincial practices at issue" (adopted on 18 February 1992, 39S/27, p. 86, para. 5.35).

⁴³⁰ *B.C. Milk Marketing Board v. Bari Cheese et al.* (11 August 1993), Vancouver C912303 (B.C.S.C.); (14 August 1996), (B.C.C.A.), unreported.

provincial marketing boards could not act at the inter-provincial or international level since they did not have the necessary federal authority. This shortcoming has now been rectified by amending the CDC Act.

7.78 In our view, the fact that most of the provincial boards are not formally incorporated as government agencies and that all or most of them are composed, completely or partially, of individuals which are also dairy producers, does not alter our conclusion. When - and to the extent that - these boards act under explicit delegated governmental authority, they can be presumed to act as an agency of the government.⁴³¹ Nor is our conclusion altered by the fact that the authority thus delegated to the boards offers the boards a certain discretion. It is precisely *because* the boards receive the authority from the governments to regulate certain areas themselves that their actions become governmental. What is important though is that Canadian governments maintain the ultimate control and supervision of most, if not all, of the boards' activities.⁴³² These governments define, and approve changes to, the boards' mandates and functions.⁴³³

7.79 The third body which plays a decision-making role under Classes 5(d) and (e) is the CMSMC.⁴³⁴ The CMSMC was established by the National Milk Marketing Plan (NMMP) which, in turn, is "a federal-provincial agreement in respect of the establishment of a National Milk Marketing Plan for the purposes of regulating the marketing of milk and cream products relating to Canadian domestic requirements and for any additional industrial milk requirements in Canada".⁴³⁵ The NMMP was entered into by nine provinces⁴³⁶ and the CDC. The bodies signing on behalf of each province are typically the provincial milk marketing board, the provincial supervisory board (which provides oversight of the operations of the provincial marketing board and is recognized by Canada as a provincial authority) and the provincial Minister for Agriculture. These two entities and the provincial Minister for Agriculture select a single "designated representative" who casts the vote on behalf of the province concerned. The CDC chairs the CMSMC and also has the right to vote. Decisions by the CMSMC are taken by consensus. In certain cases, disagreement is resolved by decision of the CDC. The CMSMC is also "the supervisory body which will oversee the implementation"⁴³⁷ of the Comprehensive Agreement on Special Class Pooling. This agreement was concluded by the same bodies that are signatories to the NMMP and prevails over the NMMP. Decisions by the CMSMC under the Comprehensive Agreement on Special Class Pooling are taken

⁴³¹ If we were to accept Canada's argument - namely, that the provincial marketing boards are not governmental agencies because they are composed mainly of milk producers and producer-driven - it would mean that also a decision by a government minister - being, for example, also a farmer or having his or her electoral base in the agricultural sector - which favoured farmers would, for that reason, no longer constitute a governmental action but a private action by farmers.

⁴³² In the *Bari III* case, for example, the Supreme Court of British Columbia found that the sub-delegation by the Governor in Council (of certain governmental powers granted to him under the CDC Act) to the CDC, the CMSMC and the provincial boards constitutes valid sub-delegation. The Court found that the functions sub-delegated are administrative, not legislative; that the sub-delegation was done out of "administrative necessity"; and that "*sufficient direction has been provided ... as to how [the CDC, the CMSC and the boards] are to perform these functions*" (*British Columbia Milk Marketing Board and Canadian Dairy Commission v. Luigi Aquilini et al.*, Reasons for Judgment of the Hon. Mr. Justice Wong, 12 September 1997, para. 117).

⁴³³ This delegation of governmental authority to the boards should be distinguished from the government's involvement in creating a legal framework for, e.g., private banks (an example referred to by Canada). The boards are not only provided with a framework within which they can operate; they receive the authority to themselves regulate certain aspects of the milk market. Private banks, on the contrary, are legally recognized and subject to certain rules and thus operate within a framework set by the government. However, they do not - like the boards - receive the power to regulate themselves, e.g., the financial markets.

⁴³⁴ See paras. 2.27-2.33.

⁴³⁵ Introduction (A) to the NMMP. On the NMMP, see paras. 2.21-2.26.

⁴³⁶ All Canadian provinces are parties to the NMMP except for Newfoundland which is, according to Canada, not a party to the NMMP because its milk producers produce almost exclusively for the local fluid milk market and because Newfoundland has not traditionally contributed to the industrial milk supply that is the subject of the NMMP.

⁴³⁷ Schedule I, Section 1 of the Comprehensive Agreement on Special Class Pooling.

by consensus. Instead of the CDC resolving disagreements, under the Comprehensive Agreement on Special Class Pooling a specific dispute settlement procedure is provided for.⁴³⁸

7.80 We have found that all of the signatories to the NMMP and the Comprehensive Agreement on Special Class Pooling – i.e., the provincial governments and provincial supervisory boards, the CDC and the provincial marketing boards – may be considered as "agencies" of Canada's governments or are effectively Canada's provincial governments. Hence, we must presume that actions taken by these "agencies" or governments through the CMSMC are, in turn, actions taken by an "agency" of Canada's governments. We recognize the influential role played by producers in the CMSMC. At the same time, however, and considering the structure, delegated powers and responsibilities of the CMSMC as outlined above⁴³⁹, the concrete government involvement in the CMSMC is more than obvious. The NMMP itself states that "the participation of the Federal and Provincial authorities is required to assure the adoption and implementation" of the NMMP.⁴⁴⁰ Most decisions by the CMSMC require the agreement of both the CDC (an agency of the federal government) and the provincial governments signatories to the NMMP (the provincial government is one of the three bodies appointing the "designated representative" of a province). In some instances, the CDC may even decide alone when there is a disagreement between the signatories of the NMMP.

The concrete government involvement in making milk available under Classes 5(d) and (e)

7.81 Given our earlier considerations that the CDC is a government agency and that most of the actions taken by the provincial milk marketing boards and the CMSMC can also be regarded as taken by an "agency" of the government, the answer to the question of whether the milk made available under Classes 5(d) and (e) – which we found earlier to be a payment in kind - is provided by Canada's governments or their agencies, becomes more apparent.

7.82 Under both Classes 5(d) and (e) processors/exporters can only access milk if they obtain a permit from the CDC, a government agency. It is not the individual producer who decides what milk it thus sells for export. It is the CDC, acting on the advice of the Surplus Removal Committee ("SRC")⁴⁴¹, the CMSMC or the provincial marketing boards, which decides whether domestic requirements are met and whether, therefore, milk should be considered as "surplus" and be exported. Such exports are made, not necessarily because no more milk could be sold on the domestic market at a higher price, but mainly in order to maintain the high domestic price.⁴⁴² As noted by the current President of the CDC, Mr. Guy Jacob:

"... the [CDC] is the organization that issues permits whereby secondary processors or exporters can purchase milk at lower prices. In other words, in order for an exporter to be able to buy milk at a lower price, he must first obtain a permit from the [CDC]. It is also the [CDC] that has the ultimate responsibility to ensure that secondary processors or exporters that purchase milk at a lower price

⁴³⁸ Annex D to the Comprehensive Agreement on Special Class Pooling, according to which the CMSMC first acts as the Supervisory Body in an attempt to resolve the dispute prior to arbitration by an arbitration Panel. The CDC acts as secretariat for all dispute settlement purposes.

⁴³⁹ See para. 7.79.

⁴⁴⁰ Preamble (B) to the NMMP, fourth paragraph.

⁴⁴¹ See para. 7.71.

⁴⁴² In the Standing Committee on Agriculture and Agri-Food of 17 March 1998, US Exhibit 45, p. 5, one Member of Parliament (Mr. Jean-Guy Chrétien) argued that many processors are willing and could produce far more dairy products for the domestic market but that they cannot access the required milk; whereas other processors, producing for export, have a much wider access to milk given that "there is no danger of flooding the domestic market". In reply, Mr. Guy Jacob, President of the CDC, stated: "Yes, we are hearing the same message from processors and producers ... Processors are saying that they would have markets and could process more milk if the raw material were available".

do in fact use that milk for the purpose for which the permit was issued".⁴⁴³

7.83 Under both Classes 5(d) and (e), once a processor/exporter has obtained the required permit from the CDC, it has to appeal to the provincial marketing board to actually obtain the milk. Although the board is not under an obligation to provide such milk, Canada submits that in practice it always does so. It is, again, not the individual milk producer which independently allocates part of its production to export sales, but rather the provincial marketing board which makes such milk available at the request of the CDC. All milk sales in Canada necessarily have to pass through the provincial marketing board. An individual producer only decides how much it *produces*; it has no control over what part of its production will be exported. The producer only knows that for over-quota production, a lower export return will be obtained.

7.84 It is the CMSMC which sets and periodically adjusts the quota level and thereby decides what share of a producers' milk production is labelled as over-quota and thus obtains lower export returns.⁴⁴⁴ It is also the CMSMC which annually sets the amount of milk allowed for export under Class 5(d). For both Classes 5(d) and (e) it is the CDC which, finally, takes the decision whether milk actually gets exported by issuing the required permit. No link exists between what is over-quota for an individual producer and what actually gets authorized for export by the CDC. Indeed, the CDC can even decide that over-quota milk should in fact not be exported but sold domestically to make up a shortfall.⁴⁴⁵

7.85 We recall, in addition, that the CDC negotiates the milk price for transactions under Classes 5(d) and (e), as well as – for exports made by the CDC itself - the processor margin; that the large majority of export sales under these Classes are initiated by the CDC⁴⁴⁶; and that the CDC itself is a major exporter of processed dairy products.⁴⁴⁷

(v) *The Panel's finding on whether the milk is provided by governments or their agencies*

7.86 As outlined above, the CDC, advised by other bodies acting under the authority delegated to them by governments, decides whether or not any and how much milk can be exported. The CDC then – in a very direct way, by providing a permit – makes milk available under Classes 5(d) and (e). Finally, the provincial milk marketing boards, acting under delegated authority, physically offer the milk to processors. We find, therefore, on the basis of the specific circumstances of this case, that the milk made available to processors for export under Classes 5(d) and (e) at a discounted price, is provided by Canada's governments or their agencies in the sense of Article 9.1(a).

(c) The Panel's finding under Article 9.1(a)

7.87 We found earlier that the provision of lower priced milk to processors for export under Classes 5(d) and (e) constitutes a payment in kind to processors/exporters contingent on export

⁴⁴³ Standing Committee on Agriculture and Agri-Food of 17 March 1998, US Exhibit 45, p. 2.

⁴⁴⁴ The quota level can vary considerably year by year and can even be adjusted during the year, so that it may be difficult for the producer to adjust production to its quota. In 1995/1996 and 1996/1997 the national quota for industrial milk (Market Sharing Quota or MSQ) was 44.2 million hL. In 1997/1998 it was decreased by 3 per cent to 43.3 million hL. In 1998/1999, on the other hand, it was increased by 4 per cent to 44.7 million hL.

⁴⁴⁵ This over-quota milk then obtains the higher domestic price, the benefit of which does not go directly to the individual producer (who only gets the lower Class 5(e) return) but is shared among all producers.

⁴⁴⁶ In 1995/1996, 96.6 per cent of surplus removal was initiated by the CDC; in 1996/1997, 91.49 per cent; in 1997/1998, 70.61 per cent.

⁴⁴⁷ See statement by Mr. Guy Jacob, President of the CDC, Standing Committee on Agriculture and Agri-Food of 17 March 1998, US Exhibit 45, p. 4: "The [CDC] remains a major exporter. Last year [1997] its direct exports totalled some 200 million dollars".

performance.⁴⁴⁸ We also found that this milk is provided by Canada's governments or its agencies.⁴⁴⁹ On these grounds⁴⁵⁰, we find that the making available of milk under Classes 5(d) and (e) constitutes an export subsidy within the meaning of Article 9.1(a).

6. Article 9.1(c) of the Agreement on Agriculture

7.88 We have found that the Special Milk Classes Scheme involves an export subsidy as listed in Article 9.1(a). The complainants submit that this scheme also constitutes an export subsidy as listed in Article 9.1(c). This provision subjects the following type of action to Canada's export subsidy commitments:

"payments on the export of an agricultural product that are financed by virtue of governmental action, whether or not a charge on the public account is involved, including payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived".

7.89 In our view, the first part of Article 9.1(c) – "payments on the export of an agricultural product that are financed by virtue of governmental action" - includes the core elements of an export subsidy as listed in that provision. The subsequent part provides further clarification – in an illustrative way - as to the meaning of these core elements. We, therefore, consider that there are two conditions that have to be met for there to be an export subsidy as provided in Article 9.1(c):

- (a) the presence of "payments on the export of an agricultural product";
- (b) which are "financed by virtue of governmental action".

We next examine whether these two conditions are met in this case.

- (a) "payments on the export of an agricultural product"

7.90 We found earlier that the provision of milk at a discounted price under Classes 5(d) and (e) involves "payments-in-kind" in the sense of Article 9.1(a) to processors/exporters that are "contingent on export performance".⁴⁵¹ Under Article 9.1(c) we need to examine whether such provision of milk involves a "payment on the export of an agricultural product". In our view, if the word "payment" in Article 9.1(c) were to include "payments-in-kind", we would have to conclude that the provision of milk at a discounted price under Classes 5(d) and (e) also constitutes a "payment" in the sense of Article 9.1(c). Since, as we saw earlier⁴⁵², the provision of this cheaper milk is only available in case the dairy products produced with it are actually exported, we would then also need to conclude that it constitutes a payment "on the export of an agricultural product".⁴⁵³ In our view, the term "payment on the export of an agricultural product" means, indeed, that the payment is conditional or contingent on the export of such product (*in casu*, the processed dairy products that are specified in the CDC permits

⁴⁴⁸ See para. 7.61.

⁴⁴⁹ See para. 7.86.

⁴⁵⁰ See also paras 7.39 and 7.40.

⁴⁵¹ See paras. 7.40 and 7.58.

⁴⁵² See para. 7.40.

⁴⁵³ Referring to para. 7.41, to the extent that the US claims also cover any of the milk classes other than Classes 5(d) and (e), we note that all of these other milk classes can also (often exclusively) be accessed by processors which produce for the domestic market. Nothing offered under these other milk classes can thus constitute a payment "on the export of" an agricultural product. We therefore find that these other milk classes do not involve an export subsidy as listed in Article 9.1(c).

issued under Classes 5(d) or (e)). Our finding as to whether or not the Special Milk Classes Scheme also involves "payments on the export of an agricultural product" in the sense of Article 9.1(c) thus only depends on whether or not the word "payment" in this provision covers not only payments in money but also "payments-in-kind". This is the issue we examine next.

7.91 We recall that according to the rules of treaty interpretation set out in Article 31 of the Vienna Convention on the Law of Treaties, the meaning of a term is to be determined by reference to its ordinary meaning, read in its context, and in the light of the object and purpose of the treaty.

7.92 As to the ordinary meaning of the word "payment", we note that the *Oxford English Dictionary* defines "payment" as

"1. the action, or an act of, paying; the remuneration of a person with money *or its equivalent*; the giving of money, *etc.* in return for something in discharge of a debt".⁴⁵⁴

This indicates that the ordinary meaning of the word "payment" includes both the act of remunerating a person with money and the act of remunerating a person with its equivalent in kind, a so-called "payment in kind". Indeed, benefits available under the export rebate system in place before the Special Milk Classes were introduced⁴⁵⁵ and the provision of *more milk for the same price* under this scheme are, in our view, both captured by the ordinary meaning of the word "payment".

7.93 The validity of this interpretation is confirmed when taking into account the context of the word "payment" as it is used in Article 9.1(c). The immediate context to turn to is, in our view, the second part of Article 9.1(c) which further defines the kind of "payment" required. It refers to a "charge" on the public account (an element *not* required for there to be an Article 9.1(c) export subsidy). We consider that a "charge" can arise both as a consequence of a transfer of money and of the provision of a good at a discounted price. The second part of Article 9.1(c) also provides an example of an export subsidy as listed in that provision. In so doing, it refers to payments "*financed from the proceeds of a levy*". "Financing" a "payment" can, in our view, be done by way of a transfer of money but also by means of charging a discounted price for a good. Therefore, the second part of Article 9.1(c), in our view, implicitly confirms that the notion of "payment" in Article 9.1(c) also covers payments-in-kind, such as the provision of milk at a reduced price.

7.94 We consider that the other provisions of the Agreement on Agriculture also form part of the context of Article 9.1(c). Article 9.1 identifies certain practices as export subsidies subject to the reduction commitments made by WTO Members. These commitments take the form of a ceiling imposed on "budgetary outlays" and on the quantity of exports for which export subsidies can be granted. They are specified for each year of the implementation period in the Schedule of the WTO Member concerned. According to Article 9.2(a), the export subsidy commitment levels represent "*with respect to the export subsidies listed in [Article 9.1]: (i) in the case of budgetary outlay reduction commitments, the maximum level of expenditure for such subsidies that may be allocated or incurred in that year in respect of the agricultural product, or group of products, concerned*".⁴⁵⁶ In principle, the ceiling on "budgetary outlays" thus applies to *all* export subsidies listed in Article 9.1, including the Article 9.1(c) export subsidies. The concept of "budgetary outlay", however, is defined in Article 1(c) as including "revenue foregone". Since, therefore, the notion of "payment" in Article 9.1(c) would also include "revenue foregone", it can be implied that "payment" thereby not

⁴⁵⁴ *The Oxford English Dictionary* (2nd Edition) – Volume XI, Clarendon Press, Oxford, pp. 379-380 (emphasis added).

⁴⁵⁵ We note in this respect that Canada, during our proceedings, acknowledged that its previous levy system – where levies were imposed on all milk producers and pay backs were made to processors/exporters with the proceeds of these levies – involved "payments" in the sense of Article 9.1(c).

⁴⁵⁶ Emphasis added.

only includes payment in money terms but also payments-in-kind, i.e., "revenue foregone" by providing milk for use in exports at a discounted price (whereby, *in casu*, higher returns to be obtained on the domestic milk market are "foregone" by producers). In other words, since "revenue foregone" is to be taken into account in calculating the *levels* of reduction commitments – including the level of export subsidies as listed in Article 9.1(c) – it should, implicitly, also be included in the *definition* of the export subsidies for which these reduction commitments are made, including the definition of export subsidies under Article 9.1(c). In our view, this consideration confirms our interpretation that "payment" in the sense of Article 9.1(c) includes "payments-in-kind".

7.95 The idea that the export subsidies identified in Article 9.1 generally, and Article 9.1(c) in particular, also include payments-in-kind and, specifically, the provision of a good at a reduced price, is also confirmed in other sub-paragraphs of Article 9.1. Article 9.1(a) refers to "direct subsidies, including payments-in-kind". Article 9.1(b) mentions the sale or disposal for export of non-commercial stocks "at a price lower than the comparable price charged for the like product to buyers in the domestic market". Article 9.1(d) refers to a *reduction in the costs* of marketing exports. Finally, Article 9.1(e) is directed at *reduced* internal transport and freight *charges* on export shipments. None of the provisions under Article 9.1 – not even Article 9.1(a) which deals with "direct subsidies" – seems to be limited to contributions in money terms only; all of them, in one way or another, explicitly or implicitly, include reference to payments-in-kind such as lower prices or a reduction in costs or charges. In our view, this consideration further confirms our interpretation that "payment" in the sense of Article 9.1(c) includes payment in kind.

7.96 Canada argues that if the drafters of the Agreement on Agriculture had intended the word "payment" in Article 9.1(c) to include payment in kind they would have explicitly added such language. Canada refers to other provisions where such language was added. It refers, in particular, to paragraph 5 of Annex 2 of the Agreement on Agriculture which mentions "direct payments (or revenue foregone, including payments in kind)". However, in our view, this inclusion of "payments in kind" does not qualify or add to the meaning of the word "payment", but to the meaning of the word "*direct* payment". Moreover, if another provision, part of the context of Article 9.1(c), defines "*direct* payments" as including "payments in kind", we consider that it can be presumed that the more general word "payments" in Article 9.1(c) *a fortiori* includes "payments in kind". Nowhere in the Agreement on Agriculture is the word "payment" as such explicitly qualified as excluding or including payment in kind. Article 9.1(a), for example, refers to "*direct subsidies* [not "payments"], including payments-in-kind". As we noted earlier, the ordinary meaning of the word "payment" as well as the context in which it is used in Article 9.1(c), on the contrary, indicate that "payment" includes not only payment in money terms but also payment in kind.⁴⁵⁷

7.97 In the same vein, Canada refers to the Appellate Body report on *Canada – Periodicals* where the term "payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges" in Article III:8(b) of GATT 1994 was interpreted as only including "the payment of subsidies which involve the expenditure of revenue by a government".⁴⁵⁸ A reduction of postal rates granted by Canada Post for the distribution of certain publications was thus found to be excluded from the exemption under Article III:8(b). In our view, however, one needs to distinguish the term "payments" as used in Article III:8(b), from that in Article 9.1(c) and this because of the different context in which it is set and the different object and purpose it serves. First, Article III:8(b) only provides a specific *exemption* to the national treatment

⁴⁵⁷ We are not convinced either by Canada's argument that the French text of Article 9.1(c) uses the word "versement" which, according to Canada, connotes only payments in money terms. We note, in this respect, that the French text of Article 9.1(a), when addressing "payments-in-kind", uses the term "versements en nature". This, in our view, confirms that also the meaning of the French term for "payment", namely "versement", does not exclude payment in kind, i.e., "versement en nature".

⁴⁵⁸ Appellate Body report on *Canada – Certain Measures Concerning Periodicals*, adopted on 30 July 1997, WT/DS31/AB/R, p. 36.

provisions in Article III for the payment of *certain production* subsidies, namely "the payment of subsidies exclusively to domestic producers".⁴⁵⁹ It does not in any way provide a general definition of what a subsidy – let alone an export subsidy – is for purposes of GATT 1994 (and even less so for purposes of the Agreement on Agriculture). Article 9.1(c), on the other hand, provides a concrete example of an export subsidy, not constituting an exemption to any other provision, but part of a positive list of export subsidies made subject to reduction commitments under the Agreement on Agriculture.⁴⁶⁰ Second, Article III:8(b) exempts the "payment of subsidies exclusively to domestic producers" from Article III obligations and provides certain "payments" as an example of such subsidies. In other words Article III:8(b) when giving the example of certain "payments" does not define or further clarify the broader term "subsidy" or "payments" – the latter term being the only one provided in Article 9.1(c) and the term we have to interpret here – but the more narrow term "payment of subsidies exclusively to domestic producers". Recalling also the textual and contextual elements proper to Article 9.1(c) set out above⁴⁶¹ – and not to be found under Article III:8(b) – we thus consider that Canada's reference to Article III:8(b) of GATT 1994 does not alter our interpretation that "payment" in Article 9.1(c) also includes payment in kind.

7.98 Canada further claims that there is no revenue for the producers to forego with respect to sales of milk for export use under Classes 5(d) and (e) and, therefore, no payment in kind made by these producers. It submits that under the Canadian milk marketing system, such milk *cannot* be sold in the market for export uses if it is required for Canadian domestic requirements. Thus, sales of milk for export purposes at prices based on world market prices cannot be made until there is no opportunity to sell milk into domestic markets at the higher domestic prices. According to Canada, "revenue foregone" implies a choice of markets, a choice foregone and in this case producers do not have a choice.

7.99 In response to Canada's argument, we agree that the milk producer – with respect to Classes 5(d) and (e) milk – does *not* have a choice to make between selling its milk at a higher price for domestic use or at a lower price for export. However, we do so for reasons different from those put forward by Canada. As we noted earlier, it is not the milk producer that takes the decision where to allocate its milk production.⁴⁶² It is the CDC (acting on the advice of the SRC), the CMSMC and the provincial marketing boards, that decide whether domestic requirements are met and whether, therefore, milk should be considered as "surplus" and be exported. Such exports are made, not necessarily because no more milk could be sold on the domestic market at a higher price, but mainly in order to maintain the high domestic price.⁴⁶³ If it is thus decided – by means of the issuance of a CDC permit under Classes 5(d) or (e) – that in-quota milk is to be exported, the milk producer *has to* accept a lower price. Through the pooling of all in-quota milk returns, this lower price is reflected in a lower average pooled price granted to milk producers for all of their in-quota milk. With respect to *over-quota* milk, it is again because of Canada's governments or their agencies – through the CMSMC

⁴⁵⁹ Article III:8(b) states: "*The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers ...*" (emphasis added).

⁴⁶⁰ In this respect, we note the Panel Report on *Indonesia – Certain Measures Affecting the Automobile Industry*, adopted 23 July 1998, WT/DS54/R, which highlights the special and different context and object and purpose of Article III and Article III:8(b) in particular, when it states in para. 14.33: "As was the case under GATT 1947, we think that Article III of GATT 1994 and the WTO rules on subsidies remain focused on different problems. Article III continues to prohibit discrimination between domestic and imported products in respect of internal taxes and other domestic regulations, including local content requirements. It does not "proscribe" nor does it "prohibit" the provision of any subsidy *per se*"; and in para. 14.43: "We consider that the purpose of Article III:8(b) is to confirm that subsidies to producers do not violate Article III, so long as they do not have any component that introduces discrimination between imported and domestic products. In our view, the wording "payment of subsidies exclusively to domestic producers" exists so as to ensure that only subsidies provided to producers, and not tax or other forms of discrimination on products, be considered subsidies for the purpose of Article III:8(b) of GATT".

⁴⁶¹ See paras. 7.92-7.96.

⁴⁶² See paras. 7.82 ff.

⁴⁶³ See para. 7.82 and footnote 442.

– that a certain quantity of milk is labelled as over-quota. Once so labelled, milk necessarily obtains a lower price based on the world market price. Therefore, whenever producers produce milk over-quota, as defined by Canada's governments or their agencies, they *have to* sell it at a lower export related price.

7.100 Canada is, therefore, correct that producers do not have a choice to make with respect to the allocation of Classes 5(d) and (e) milk. However, in our view, this is so (i.e., the producers' choice is predetermined) *not* – as Canada implies – because of commercial reasons (e.g., because of a lower domestic demand the producer – depending on its profitability – decides, in order to maximize its total revenue, to allocate a certain share of its production to lower priced export markets), but because of governmental actions. Under the Canadian system, selling milk for use in the domestic market is no longer an option (i.e., the choice for a higher return is taken away) mainly because the quotas – set by Canadian governments or their agencies – are met; *not* because there is no more domestic demand for milk. As noted earlier, producers would likely be able to sell more milk domestically if they were allowed to do so, albeit probably at a somewhat lower price.⁴⁶⁴ In conclusion, we consider that producers do forego a choice or revenue – albeit through governmental action – and, therefore, make a payment in kind to processors/exporters in the sense of Article 9.1(c).

7.101 In conclusion, a careful examination of the ordinary meaning of the term "payment" in Article 9.1(c), in its context and in light of the object and purpose of the Agreement on Agriculture, leads us to the conclusion that it does include payment in kind and thus, *in casu*, the provision of milk at a reduced price. Recalling our considerations in paragraph 7.90, we thus find that the provision of milk to processors/exporters under Classes 5(d) and (e) involves a "payment on the export of an agricultural product" in the sense of Article 9.1(c).

(b) payments "financed by virtue of governmental action"

7.102 We recall that it is not in dispute that the payments-in-kind made under Classes 5(d) and (e) do *not* directly involve a charge on the public account.⁴⁶⁵ The cost of selling milk at a reduced price for export is not borne by the government. It is borne by the milk producers either *collectively* (by means of pooling the lower in-quota export returns with the higher domestic returns and paying out an average pooled price for all in-quota milk to all producers) or, at least in principle, *individually* (with respect to over-quota milk, revenues of which are generally not pooled with higher returns from other milk producers). However, in our view, it is clear from the language of Article 9.1(c) that producer-financed payments can in principle be covered by this provision. "[W]hether or not a charge on the public account is involved" is explicitly stated to be irrelevant for purposes of Article 9.1(c). Moreover, Article 9.1(c) explicitly provides an example of a producer-financed payment, covered by Article 9.1(c), namely "payments that are financed from the proceeds of a levy imposed on the agricultural product concerned or on an agricultural product from which the exported product is derived". The word "including" indicates that such payments financed from levies on agricultural products constitute only one example of a producer-financed export subsidy as listed in Article 9.1(c). In order to decide whether or not the scheme at issue here is another example of such export subsidies, we need to determine next whether or not this scheme involves payments "financed by virtue of governmental action".

7.103 We found earlier that the type and degree of government involvement in the making available of milk to processors/exporters under Classes 5(d) and (e) is such that the payment in kind involved is "provided by" Canada's governments or their agencies in the sense of Article 9.1(a).⁴⁶⁶ We recall, in

⁴⁶⁴ *Ibid.*

⁴⁶⁵ See para. 7.64.

⁴⁶⁶ See para. 7.86.

particular, that Canada's governments or their agencies through the Special Milk Classes Scheme decide when milk is to be exported, negotiate the price for such milk and actually provide the milk to processors/exporters.

7.104 We note, in addition, that it is the provincial milk marketing board, assisted by the CDC and operating under federal and/or provincial authority delegated to it, that (i) calculates the monthly pay cheque to be sent to each milk producer according to the relevant pooling arrangements and the specific rules or regulations the province concerned applies with respect to payments for over-quota milk; and (ii) eventually pays the milk producers a monthly income based on their production and the milk returns obtained through the scheme during a certain period. All milk necessarily passes through the intermediary of the provincial milk marketing boards which, together with the CDC and the CMSMC, arrange all milk sales, cash the returns obtained from processors/exporters for the milk sold and, finally, re-route these returns – including, in particular, the returns from milk sold under Classes 5(d) and (e) - to the individual milk producers on the basis of complex calculations.

7.105 We further note that, by virtue of the CDC Act, the CDC is, *inter alia*, authorized to (i) "distribut[e] money to producers of milk or cream received from the marketing of any quantity of milk or cream"⁴⁶⁷; (ii) "establish the price, or minimum or maximum price, paid or to be paid to the Commission, or to producers of milk or cream, the basis on which that payment is to be made and the terms and manner of payment that is to be made in respect of the marketing of any quantity of milk or cream"⁴⁶⁸; and (iii) "collect the price paid or to be paid to the Commission, or to any producer in respect of the marketing of any quantity of milk or cream ... or recover that price in a court of competent jurisdiction".⁴⁶⁹ The CDC also calculates the returns received by each province for Special Milk Classes sales, based on data provided by provincial marketing boards, and may audit the books of processors/exporters to ensure that they have used Classes 5(d) and (e) milk for export purposes.

7.106 On these grounds⁴⁷⁰, we find that the payment in kind offered under Classes 5(d) and (e), namely the provision of milk at a discounted price to processors/exporters, although it is not financed directly with governmental funds, is, nevertheless, "financed by virtue of governmental action" in the sense of Article 9.1(c).

Additional considerations with respect to sales of in-quota milk

7.107 We find additional support for our finding in the previous paragraph, in so far as it relates to *in-quota* milk sold under Classes 5(d) or (e), in the fact that the returns of in-quota milk are pooled with all other in-quota milk returns.⁴⁷¹

7.108 At the national level, a system which pools all returns from in-quota milk in Special Class 5 was set up in the Comprehensive Agreement on Special Class Pooling. This agreement was concluded by the same bodies that established the CMSMC. Its implementation is overseen by the CMSMC, a body we considered earlier to be (at least to some extent) an agency of Canada's governments.⁴⁷² Moreover, in order to allow the CDC to administer this pooling system, the federal CDC Act was

⁴⁶⁷ CDC Act, Subsection 9(1), paragraph (f), (i).

⁴⁶⁸ CDC Act, Subsection 9(1), paragraph (g).

⁴⁶⁹ CDC Act, Subsection 9(1), paragraph (h).

⁴⁷⁰ See paras. 7.103-7.105.

⁴⁷¹ In this respect, we note that New Zealand and the United States have argued that Classes 5(d) and (e) constitute an export subsidy to milk *processors/exporters* financed by milk producers contingent on the export of the processed *dairy product*. Neither complainant suggested that the pooling of in-quota milk returns represents a payment to some *milk producers* financed by other milk producers contingent on the export of *milk*.

⁴⁷² See para. 7.80.

amended. Subsection 9(1), paragraph (f) of the Act, as amended, grants federal authority to the CDC to "establish and operate a pool or pools in respect of the marketing of milk or cream".

7.109 At an inter-provincial level, one pooling agreement was concluded between six eastern provincial boards ("the P6 Agreement"), another between four western provincial boards ("the P4 Agreement"). Both of these agreements pool all in-quota milk returns other than Special Class 5 returns (which are pooled nationally). These agreements were typically concluded by the relevant provincial governments, marketing boards and supervisory boards, all of which we presumed earlier to be agencies of Canada's governments.⁴⁷³ Also the CDC itself is a signatory to both of these agreements. An example of how pooling of in-quota milk actually occurs is provided in paragraphs 2.59 to 2.63 above.

7.110 The authority vested in the provincial marketing boards to conclude, operate and enforce any of these three pooling agreements was delegated to them either by federal authorities (to the extent inter-provincial and international trade is involved, e.g., by the CDC⁴⁷⁴) or by provincial authorities (which have constitutional authority over all other aspects of production and sale of milk). The orders and regulations of the boards in respect of pooling – established pursuant to federal and provincial enabling legislation – can be enforced by the provincial boards before the normal courts by means of, e.g., a request for civil injunction or civil damages.

7.111 On these grounds, we consider that each of the three pooling arrangements are imposed on milk producers by virtue of governmental action. The pooling agreements are compulsory. Individual producers cannot opt-out of these pooling systems with respect to their in-quota milk.⁴⁷⁵ It is this pooling mechanism that "finances" the payment in kind provided by the producers to the processors/exporters under Classes 5(d) and (e) with respect to in-quota milk. The pooling ensures that the producer which sells in-quota milk for export at a discounted price, does not have to bear the *total* cost of the "payment" thus provided to the processor/exporter. *All* milk producers share this cost by putting their higher returns from milk sold for domestic use in the same pool. The net result is that all producers obtain one average pooled price for all their in-quota milk. This pooling system confirms our finding that the provision of in-quota milk under Classes 5(d) and (e) is a payment in kind "financed by virtue of governmental action".⁴⁷⁶

Additional considerations with respect to sales of over-quota milk

7.112 We note, finally, that even though returns of *over-quota* milk sold under Class 5(e) are *generally* not pooled with other *in-quota* milk returns, over-quota milk returns are also, at least to some extent, pooled. This again occurs, we consider, by virtue of governmental action. First, any over-quota milk return is pooled annually with all other over-quota milk returns. On a monthly basis, the individual milk producer receives, from its provincial marketing board, a price for its monthly over-quota share. This price is *not* the actual return for the transaction made, but a three-month moving average of all returns achieved nationally for over-quota milk. Moreover, at the end of the dairy year, an adjustment is made to ensure that the total monthly payments made to individual producers correspond, on an averaged basis, to the total returns generated nationally that year by all over-quota milk sales. Therefore, even though each export transaction may – and mostly does - generate a different price (depending on the competitive conditions in the export market concerned, the dairy

⁴⁷³ See paras. 7.73 ff.

⁴⁷⁴ In Schedule II to the Comprehensive Agreement on Special Class Pooling, the CDC, subject to the approval of the Governor in Council, authorizes the provincial boards "insofar as it is necessary to enable the Boards to fully carry-out the program as set out in [the Comprehensive Agreement on Special Class Pooling] and its Annexes, to exercise all the powers of the [CDC] set out in paragraphs 9(1)(f) to (i) of the [CDC Act]".

⁴⁷⁵ See Canada's answer to Panel Question 4(d) to Canada.

⁴⁷⁶ See para. 7.106.

product in question and the delivery terms and timing of the transaction), at the end of the year an individual milk producer is not affected by this spectrum of variables, but receives a nationwide average pooled return for all of its over-quota milk.⁴⁷⁷ Second, depending on the applicable provincial regulations, some degree of pooling also takes place between over-quota returns and in-quota returns. This is achieved, in some provinces, by offsetting over-quota production of some producers against under-quota production of others.⁴⁷⁸ These so-called "flexibility" provisions or "fall incentives" essentially excuse over-quota production in certain months. This variable determination of what is labelled as over-quota milk in each province by virtue of provincial regulations, not only results in a shared financing of certain over-quota sales (including by those producers which did not produce over-quota); it also confirms that it is not the individual producer but Canada's governments or their agencies that essentially determine when milk receives the lower export return. In our view, this pooling of over-quota returns confirms our finding in paragraph 7.106 that the provision of over-quota milk under Class 5(e) is also a payment in kind "financed by virtue of governmental action".

(c) The Panel's finding under Article 9.1(c)

7.113 We found earlier that the provision of lower priced milk to processors for export under Classes 5(d) and (e) constitutes a "payment" to these processors/exporters "on the export of an agricultural product".⁴⁷⁹ We also found that this "payment" is "financed by virtue of governmental action".⁴⁸⁰ On these grounds, we find that the making available of milk under Classes 5(d) and (e) constitutes an export subsidy within the meaning of Article 9.1(c).

7. Article 3.3 of the Agreement on Agriculture

7.114 We have found that the provision of milk to processors/exporters at a reduced price under Classes 5(d) and (e) constitutes an export subsidy as listed in Article 9.1(a)⁴⁸¹ and Article 9.1(c).⁴⁸² We recall that Article 3.3 provides as follows:

"Subject to the provisions of paragraphs 2(b) and 4 of Article 9, a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule".

7.115 We further note that, according to figures submitted by Canada, the total amount of exports generated through Classes 5(d) and (e) exceeds Canada's quantity reduction commitment levels as set out in Section II of Part IV of its Schedule and this (i) for all of the dairy products in dispute (butter, cheese and "other milk products") and (ii) during both marketing years at issue (1995/1996 and 1996/1997).⁴⁸³ The relevant figures are reflected in the table below:

⁴⁷⁷ See Canada's answer to Panel Question 34 to Canada.

⁴⁷⁸ For example, in the provinces of Alberta, Manitoba and Saskatchewan, according to Canada's answer to Panel Question 20(b) to Canada and US Exhibits 39 and 58.

⁴⁷⁹ See paras. 7.90 and 7.101.

⁴⁸⁰ See paras. 7.103 ff.

⁴⁸¹ See para. 7.87.

⁴⁸² See para. 7.113.

⁴⁸³ See Table 2 in para.2.41.

Product	Marketing Year	Canada's Export Quantity commitment level	Total exports generated through Classes 5(d) and 5(e)
Butter	1995/1996	9,464	9,527
	1996/1997	8,271	10,312
Cheese	1995/1996	12,448	13,751
	1996/1997	11,773	20,409
Other milk products	1995/1996	36,990	37,358
	1996/1997	35,649	60,300

7.116 On these grounds⁴⁸⁴, we find that Canada provides export subsidies as listed in Article 9.1 in respect of the three dairy products at issue, and this for both marketing years in dispute, in excess of the quantity commitment levels specified in its Schedule, contrary to its obligations under Article 3.3.

8. Article 10 of the Agreement on Agriculture

7.117 We have found that the Special Milk Classes Scheme involves an export subsidy as listed both in Article 9.1(a) and in Article 9.1(c). In the alternative – i.e., in the event we would have found that the scheme does *not* involve an export subsidy as specified in either Article 9.1(a) or Article 9.1(c) – the Complainants submit that this scheme, nevertheless, constitutes an export subsidy contrary to Article 10.1 of the Agreement on Agriculture. This provision reads 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".

7.118 The Complainants only invoke the first phrase of Article 10.1. We note that this phrase only applies to "export subsidies *not* listed in paragraph 1 of Article 9". Export subsidies listed in Article 9.1 cannot, therefore, be found to contravene Article 10.1.⁴⁸⁵ Having found that Canada's Special Milk Classes 5(d) and (e) involve export subsidies as listed in Article 9.1, we thus decide this dispute on the basis of Article 9.1. None of the complainants requested the Panel to make concurrent findings on both Article 9.1 and Article 10.1. In our view, the text of Article 10.1 and our findings based on Article 9.1 exclude such concurrent findings in respect of the same export subsidies. If our findings under Article 9.1 are adopted by the DSB, we consider that making additional findings under Article 10.1 would not be warranted in the light of the mutually exclusive relationship between Article 9.1 and Article 10.1.

7.119 However, in our examination of the claims relating to violations of Article 9.1 *or* Article 10.1, we also noted the following elements:

- (a) both complainants requested a finding on Article 10.1 in the event that Article 9.1 were found not to be applicable;

⁴⁸⁴ See paras. 7.114-7.115.

⁴⁸⁵ However, in our view, the mutual exclusiveness of Article 9.1 and Article 10.1 does not prevent that one element or aspect of a given scheme may constitute an export subsidy as listed in Article 9.1, while another element or aspect of the same scheme may be covered by Article 10.1 and that, as a result, the factual elements to be considered under both provisions might well be closely related if not the same in certain respects.

- (b) the complainants and Canada disagree on how Article 10.1 should be construed and on the consistency of Canada's Special Milk Classes Scheme with Article 10.1;
- (c) both Article 9.1 (referring to Article 3.3) and Article 10.1 prohibit specified export subsidies and, in so doing, complement each other by focusing on different subsidy elements. As a result, the precise borderline between Article 9.1 and Article 10.1 export subsidies may not always be clear-cut. Indeed, so far this borderline has never been clarified in WTO legal or dispute settlement practice;
- (d) if our findings under Article 9.1 were to be reversed, the Appellate Body could be called upon to examine the claims made under Article 10.1. This examination would require a complex factual assessment and the weighing of evidence submitted by the parties to this dispute, an exercise which could go beyond the jurisdiction of the Appellate Body and make it impossible for the DSB to provide recommendations and rulings on all legal claims within the time-frame prescribed by the DSU;
- (e) if the DSB adopts our findings on Article 9.1, the DSU's declared objectives of "prompt settlement" of disputes (Article 3.3 of the DSU), of a "satisfactory settlement of the matter in accordance with the rights and obligations under [the DSU] and the covered agreements" (Article 3.4 of the DSU), of "a positive solution to a dispute" (Article 3.7 of the DSU) and of "effective resolution of disputes to the benefit of all Members" (Article 21.1), may be facilitated if the parties would have at their disposal the Panel's examination of the matter under Article 10.⁴⁸⁶ On this point, we recall the following statement by the Appellate Body:

"The principle of judicial economy has to be applied keeping in mind the aim of the dispute settlement system. This aim is to resolve the matter at issue and 'to secure a positive solution to a dispute'.⁴⁸⁷ To provide only a partial resolution of the matter at issue would be false judicial economy. A panel has to address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member with those recommendations and rulings 'in order to ensure effective resolution of disputes to the benefit of all Members'⁴⁸⁸."

On these grounds, and in particular in order to (i) enable the Appellate Body and the DSB to make findings on Article 10.1 in the event that it considers it necessary⁴⁹⁰ and (ii) avoid a continuation of the

⁴⁸⁶ In this respect, we also note Article 19.1 of the DSU providing that a panel "[i]n addition to its recommendations ... may suggest ways in which the Member concerned could implement the recommendations".

⁴⁸⁷ A footnote refers to DSU, Article 3.7.

⁴⁸⁸ A footnote refers to DSU, Article 21.1.

⁴⁸⁹ Appellate Body report on *Australia – Measures Affecting Importation of Salmon*, WT/DS18/AB/R, adopted 6 November 1998, para. 223.

⁴⁹⁰ In this respect, we refer to the dispute on *Australia – Measures Affecting Importation of Salmon* (WT/DS18/AB/R, adopted 6 November 1998), where the Appellate Body, after having reversed certain Panel findings, was "unable to come to a conclusion on [the claim under Article 5.6 of the SPS Agreement] due to the insufficiency of the factual findings of the Panel and of facts that are undisputed between the parties" (para. 213; see also para. 241). See also the Appellate Body Report on *Canada – Certain Measures Concerning Periodicals*

dispute over Canada's obligation to bring its dairy products marketing regime into conformity with its obligations under the Agreement on Agriculture, we have decided to proceed with our examination under Article 10.1 and to include that examination in our report as one on which no recommendation or ruling by the DSB would be necessary if our findings under Article 9.1 are adopted. We emphasize that our examination of Article 10.1 is made in the alternative only, i.e., assuming that Classes 5(d) and (e) do not involve export subsidies as listed in Article 9.1.

(a) The two elements under Article 10.1

7.120 In our view, for there to be a violation of Article 10.1, two elements need to be established:

- (a) the presence of "export subsidies not listed in paragraph 1 of Article 9";
- (b) which are "applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments".

7.121 Article 10.1 - in particular the second condition thereunder - has to be read together with Article 10.3, which 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".

7.122 Reading the second element of Article 10.1 together with Article 10.3, we note that all parties to this dispute agree that one example of applying export subsidies "in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments" is a situation where export subsidies other than Article 9.1 export subsidies are granted to a product subject to subsidy reduction commitments in excess of the reduction commitment level.⁴⁹¹ We see no reason, in the circumstances of this case, to disagree with this interpretation of Article 10. In our view, Article 10.3 does, indeed, address both (i) the question of who bears the burden of proving whether or not an export subsidy is at issue in a specific instance⁴⁹², and (ii) the question of when certain export subsidies can be said to be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments.

7.123 We recall that, in this case, figures submitted by Canada show that for all of the dairy products in dispute and this during both marketing years at issue, the total amount of exports generated through Classes 5(d) and (e) exceeds Canada's reduction commitment level.⁴⁹³ We also recall our consideration above that granting export subsidies "other" than those listed in Article 9.1 in excess of the relevant reduction commitment level for the subsidized product concerned, is sufficient to conclude that Article 10.1 is violated.⁴⁹⁴ Therefore, in the circumstances of this dispute, whether or not Article 10.1 is

(WT/DS31/AB/R, adopted 30 July 1997, p. 22: "We note that, due to the absence of adequate analysis in the Panel Report in this respect, it is not possible to proceed to a determination of like products [under Article III:2, first sentence, of GATT 1994]"). In this respect, see also the Panel Report on *India – Patent Protection for Pharmaceutical and Agricultural Chemical Products* (WT/DS50/R, adopted 16 January 1998) where the Panel decided to continue its examination under Article 63 of the TRIPS Agreement after it had found a violation under Article 70.8 of that Agreement (para. 7.44: "Although the United States formulates it [the Article 63 claim] as an alternative claim in the event that the Panel were to find that India has a valid mailbox system in place, and we have, as stated above, found that the current mailbox system in India is at variance with Article 70.8(a) of the TRIPS Agreement, we believe it necessary to make our findings clear on the issue of transparency in order to avoid a legal vacuum in the event that, upon appeal, the Appellate Body were to reverse our findings on Article 70.8").

⁴⁹¹ See, in particular, Canada's answer to Panel Question 16 to Canada.

⁴⁹² See paras. 7.32-7.34.

⁴⁹³ See para. 7.115, referring to Table 2 in para. 2.41.

⁴⁹⁴ See para. 7.122.

violated depends on whether or not Classes 5(d) and (e) involve an "other" export subsidy in the sense of Article 10.1. In other words, in this dispute, we only need to further examine whether the first element of Article 10.1 is met.

(b) An "other" export subsidy under Article 10.1

7.124 The Article 10.1 concept of "[e]xport subsidies not listed in paragraph 1 of Article 9" is not further defined in Article 10 itself. Article 1(e) states, however, that:

"[i]n this Agreement, unless the context otherwise requires: ... 'export subsidies' refers to *subsidies contingent upon export performance*, including the export subsidies listed in Article 9 of this Agreement".⁴⁹⁵

For purposes of Article 10.1, we thus need to examine whether Classes 5(d) and (e) involve "subsidies contingent upon export performance" in the sense of Article 1(e) other than those listed in Article 9.1. Since we assumed earlier – in the alternative and for purposes only of our examination under Article 10.1 – that Classes 5(d) and (e) do *not* involve export subsidies as listed in Article 9.1, we need to examine next whether they do, nevertheless, constitute export subsidies in the sense of Article 1(e).⁴⁹⁶

7.125 In our view, Article 1(e) covers a wider range of "export subsidies" than the specific practices listed in Article 9.1. Article 1(e) explicitly states that it "includes" – and is thus not limited to – export subsidies listed in Article 9.1. We consider, therefore, that any subsidy contingent upon export performance other than one listed in Article 9.1 is covered by Article 10.1. Accordingly, measures which meet some but not all of 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". However, neither the wording of Article 9.1, Article 10 nor Article 1(e) explicitly indicates which of the Article 9.1 limitations are no longer valid under Article 10.1. The guidance that *can* be derived from Article 9.1, as part of the context of Article 1(e) and Article 10.1, is that Article 10.1 must include certain payments-in-kind and producer-financed schemes which do not fully meet all elements under, respectively, Article 9.1(a) or Article 9.1(c). In this respect, it could, for example, be argued that where Article 9.1(a) addresses the provision by governments or their agencies of "direct subsidies, including payments-in-kind" contingent on export performance, Article 10.1 can be presumed to cover the indirect version of such subsidies.

7.126 We find further guidance to interpret the meaning of a subsidy contingent upon export performance for the purposes of Article 1(e) and Article 10.1, *inter alia*, in the SCM Agreement which is, we consider, part of the general context of Article 1(e) and Article 10.1. Article 1 of the SCM Agreement, for example, includes as a subsidy "any form of income or price support in the sense of Article XVI of GATT 1994" whereby a benefit is conferred. However, since in this case we need to interpret the meaning of certain "export subsidies", we consider it more appropriate, without prejudice to the scope of Article 10.1, 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. Annex I to the SCM Agreement – the Illustrative List of Export Subsidies – identifies practices which are, under Article 3 of the SCM Agreement,

⁴⁹⁵ Emphasis added.

⁴⁹⁶ With reference to para. 7.41 and footnote 453, to the extent that the US claims also cover any of the milk classes other than Classes 5(d) and (e), we note that all of these other milk classes can also (often exclusively) be accessed by processors which produce for the domestic market. Nothing offered under these other milk classes is thus "contingent upon export performance". We therefore find that these other milk classes do not involve an export subsidy in the sense of Article 10.1.

"subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance". Both complainants invoke Paragraph (d) of the Illustrative List which provides that the following action is an "export subsidy" for purposes of the SCM Agreement:

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

A footnote added to the term "commercially available" states:

"The term 'commercially available' means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations".

7.127 Given that Paragraph (d) deals with the provision of products at different prices for, on the one hand, use in the production of *exported goods* and, on the other hand, use in the production of *goods for domestic consumption*, we agree with the parties that Paragraph (d) under the Illustrative List is the most relevant one to this case. We next examine whether the provision of milk at a lower price for export under Classes 5(d) and (e) falls within the scope of Paragraph (d).

7.128 In our view, Paragraph (d), applied to the facts of this case, requires the presence of three elements:

- (a) the provision 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";
- (b) such provision of products for use in the production of exported goods is provided "by governments or their agencies either directly or indirectly through government-mandated schemes"; and
- (c) the more favourable terms or conditions for such products for use in the production of exported goods are also "more favourable than those commercially available on world markets to their exporters"; these terms or conditions will only *not* be more favourable than those commercially available on world markets when the choice to be made by processors/exporters between buying either domestic products or imported products "is unrestricted and depends only on commercial considerations".

7.129 As to the first element under Paragraph (d), it is undisputed that through Classes 5(d) and (e) domestically produced milk is provided for use in the production of exported goods (processed dairy products) on terms and conditions more favourable than for provision of the same domestically produced milk for use in the production of dairy products for domestic consumption.⁴⁹⁷ As we found

⁴⁹⁷ See Table 3 in para. 2.51.

earlier, the price differential between milk for use in exports and milk for use on the domestic market is significant.⁴⁹⁸ We thus find that the first element under Paragraph (d) is met.

7.130 Examining the second element under Paragraph (d), we recall our analysis under Article 9.1(a) on the basis of which we found that under Classes 5(d) and (e) milk for export at a discounted price is "provided by" Canada's "governments or their agencies".⁴⁹⁹ Even if we would have found that such lower priced milk is *not* "provided by" Canada's "governments or their agencies" – something we could assume here given that our examination under Article 10.1 is one in the alternative, i.e., on the assumption that the scheme is *not* an Article 9.1(a) export subsidy - we still consider that the evidence of record, outlined in paragraphs 7.68 to 7.85, is conclusive for us to find that such milk is, nevertheless, "provided by" Canada's "governments or their agencies either directly or indirectly through government-mandated schemes"⁵⁰⁰ in the sense of Paragraph (d). Indeed, in the event milk were not directly provided by Canada's governments or their agencies under Classes 5(d) and (e), in our view, it is at least indirectly provided through government-mandated schemes. For there to be such schemes we do not consider it necessary, as argued by Canada, that the federal or provincial governments specifically direct a certain outcome or course of action to be achieved or taken by the CDC, the provincial marketing boards or the CMSMC. In our view, the ordinary meaning of the term "government-mandated" scheme – in its immediate context of products being provided "*indirectly through government-mandated schemes*" – also includes the delegation of authority by the government to its agencies which, in turn, set up a "government-mandated" scheme.⁵⁰¹ We thus find that in this case the second element under Paragraph (d) is met.

7.131 Finally, referring to the third element under Paragraph (d), we recall our examination of whether or not the provision of milk to processors/exporters under Classes 5(d) and (e) confers a benefit to these processors/exporters, in such a way that one can conclude that a payment in kind is made to them in the sense of Article 9.1(a).⁵⁰² We recall, in particular, those paragraphs where we applied the benchmark of whether processors/exporters can access milk, or for that matter milk derivatives, from any other source - in particular the world market - on terms and conditions equally favourable to those offered under Classes 5(d) and (e).⁵⁰³ There we found that "the provision of milk to processors/exporters under Classes 5(d) and (e) at a price significantly lower than the domestic milk price ... and on terms and conditions which are more favourable than those under any other alternative source, including under the Import for Re-Export Program ... - confers a "benefit" ... to these processors/exporters and, for that reason, constitutes a payment in kind – namely, the provision of a good at a discounted price - in the sense of Article 9.1(a)".⁵⁰⁴ Even if we had found that Classes 5(d) and (e) do *not* involve the payment in kind referred to in Article 9.1(a) - something we could assume here given that our examination under Article 10.1 is one in the alternative, i.e., on the assumption that the scheme is *not* an Article 9.1(a) export subsidy - we nevertheless consider that the evidence of record is conclusive for us to find that the provision of milk under Classes 5(d) and (e) is made on "terms or conditions ... more favourable than those commercially available on world markets" in the sense of Paragraph (d). We refer, in particular, to paragraphs 7.52 to 7.56 which, in our view, provide sufficient proof that the choice to be made by processors/exporters between accessing milk under Classes 5(d) or (e) and sourcing milk, or for that matter milk derivatives – in the event these milk

⁴⁹⁸ See para. 7.50.

⁴⁹⁹ See paras. 7.63-7.86.

⁵⁰⁰ Emphasis added.

⁵⁰¹ The *New Shorter Oxford English Dictionary* (Ed. Brown, L., Clarendon Press, Oxford, Volume 1, p. 1683) defines "mandate" as follows: "1. Command, require by mandate; necessitate ... 4. Give a mandate to, delegate authority to (a representative, group, organization, etc.)".

⁵⁰² See paras. 7.46 ff.

⁵⁰³ See paras. 7.49-7.58.

⁵⁰⁴ Para. 7.58, emphasis added.

derivatives could be considered to be directly competitive with fluid milk (an issue which is in dispute⁵⁰⁵) and assuming that the availability of a directly competitive product is relevant in cases where the like product is not available – is not a choice which is "unrestricted and depends only on commercial considerations" in the sense of the footnote to Paragraph (d). We recall, in particular, the discretion granted to the Minister of Foreign Affairs and International Trade who has to issue a permit for imports to be allowed⁵⁰⁶; the fact that to date commercial imports of fluid milk cannot, for all practical purposes, enter Canada⁵⁰⁷; and the figures submitted to us which indicate – albeit in general terms only – that under Classes 5(d) and (e) milk can be sourced on more favourable terms and conditions than under, e.g., the Import for Re-Export Program, an indication reflected also in the overwhelming preference of processors/exporters for milk under Classes 5(d) and (e).⁵⁰⁸

7.132 For the above reasons⁵⁰⁹, we find that Classes 5(d) and (e) involve an export subsidy as listed in Paragraph (d) of the Illustrative List of Export Subsidies annexed to the SCM Agreement. We do not consider it necessary in this case to decide whether the fact that a scheme involves an export subsidy under the SCM Agreement necessarily means that it also constitutes an export subsidy under Article 1(e) of the Agreement on Agriculture. We are not called upon – and do not intend here – to decide whether the scope of the concept of export subsidy under the SCM Agreement is the same as, or different than, that under the Agreement on Agriculture. We do find, however, that in the circumstances of this case and on the grounds outlined above⁵¹⁰, Classes 5(d) and (e) – assuming, in the alternative, that they do *not* constitute an export subsidy as listed in either Article 9.1(a) or Article 9.1(c) – nevertheless involve an "other" export subsidy in the sense of Article 10.1.

7.133 Given our finding in the previous paragraph and recalling: (i) our consideration above that granting export subsidies "other" than those listed in Article 9.1 in excess of the relevant reduction commitment level for the subsidized product concerned, is sufficient to conclude that Article 10.1 is violated⁵¹¹; and (ii) the fact that for all of the dairy products in dispute and this during both marketing years at issue, the total amount of exports generated through Classes 5(d) and (e) does exceed Canada's reduction commitment levels, we find that Canada – in the alternative, i.e., only in the event Classes 5(d) and (e) do not involve export subsidies as listed in either Article 9.1(a) or Article 9.1(c) – has acted inconsistently with its obligations under Article 10.1 with respect to all three dairy products at issue and during both marketing years in dispute.

9. Article 8 of the Agreement on Agriculture

7.134 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) or Article 10.1 we found earlier⁵¹², Canada has acted inconsistently with its obligations under Article 8.

⁵⁰⁵ See para. 7.55.

⁵⁰⁶ See para. 7.53.

⁵⁰⁷ See para. 7.54.

⁵⁰⁸ See para. 7.56.

⁵⁰⁹ See paras. 7.129-7.131.

⁵¹⁰ See paras. 7.124-7.131.

⁵¹¹ See para. 7.122.

⁵¹² See, respectively, in paras. 7.116 and 7.133.

10. Article 3 of the SCM Agreement

7.135 The United States also claims that the provision of milk under Classes 5(d) and (e) is inconsistent with Canada's obligations under Article 3 of the SCM Agreement which contains, *inter alia*, a general prohibition on export subsidies.

7.136 We have found that the Canadian scheme is inconsistent with: (i) Canada's obligations under both Article 3.3 and Article 8 (through Article 9.1(a) and Article 9.1(c))⁵¹³; or (ii) in the alternative, Canada's obligations under both Article 10.1 and Article 8⁵¹⁴, of the Agreement on Agriculture. Therefore, the exemption provided for in Article 13(c)(i) of the Agreement on Agriculture from actions under Article 3 of the SCM Agreement for "export subsidies that conform fully to the provisions of Part V" of the Agreement on Agriculture, does not apply. In principle, the scheme could therefore also be subjected to an examination under Article 3 of the SCM Agreement.

7.137 Article 3 is identified in the US request for this Panel and could thus, in principle, be presumed to fall within the Panel's terms of reference.⁵¹⁵ The question then arises whether we could and, as the case may be, should apply the principle of judicial economy and decide *not* to examine the US claim under Article 3. We recall the Appellate Body's statement in *Australia – Salmon*, quoted earlier⁵¹⁶, which provides the most recent statement on when judicial economy can be exercised.

7.138 We note, firstly, that although the United States extensively referred to the SCM Agreement as *context* of its claims under the Agreement on Agriculture, the US arguments on its *claim* under Article 3 of the SCM Agreement are minimal.⁵¹⁷ The US' only argument under Article 3 is effectively that because Canada violated its export subsidy commitments under the Agreement on Agriculture, it thereby automatically violates its obligations under Article 3 of the SCM Agreement.⁵¹⁸

7.139 Secondly, we note that Article 4 of the SCM Agreement (entitled "Remedies") provides for "special or additional rules and procedures on dispute settlement" (as referred to in Article 1.2 of the DSU) in respect of claims made under Article 3. Article 4 sets out rights and obligations which may benefit either party to a dispute. It obliges panels to give recommendations that differ from those generally made under the DSU, a right which may be beneficial to complaining parties. Pursuant to Article 4.7, a panel *has to* recommend to the DSB that the subsidy be withdrawn without delay and *has to* specify the time-period allowed for such withdrawal. However, Article 4 also requires, in paragraph 2, that a request for consultations "include a statement of available evidence with regard to the existence and nature of the subsidy in question", a provision which may work to the advantage of the defending party. The same is true, in our view, in respect of Article 4.5 which states that "[u]pon its establishment, the panel may request the assistance of the Permanent Group of Experts ... with

⁵¹³ See paras. 7.116 and 7.134.

⁵¹⁴ See paras. 7.133 and 7.134.

⁵¹⁵ The question arises, however, whether we can examine the Article 3 claim at all (even though Article 3 is mentioned in the US Panel request) given that in the US request for consultations and for establishment of this Panel, the United States only invoked - as a legal basis for consultations and a Panel on its SCM claim - Article 30 of the SCM Agreement, i.e., the general provision on "Dispute Settlement" (together with Articles 4 and 6 of the DSU), and *not* the more specific Article 4 of the SCM Agreement which sets out certain special and additional dispute settlement procedures for cases involving prohibited subsidies. We note that - given the multiple claims submitted in this dispute (both under the Agreement on Agriculture and the SCM Agreement) - the United States could, for example, have invoked Article 4 as a legal basis to obtain recommendations with respect to its Article 3 claim, while at the same time waive its right to, *inter alia*, those elements of the accelerated procedure under Article 4 that are at odds with the usual timetable applicable under the DSU. However, as further discussed below, we do not consider it necessary to answer these questions in this case.

⁵¹⁶ See para. 7.119.

⁵¹⁷ The only US argument is, indeed: "Consequently, these export subsidies are also inconsistent with Canada's obligations under Article 3 of the SCM Agreement" (US first submission, para. 125).

⁵¹⁸ In this respect, we note, however, that as opposed to our examination of this dispute under the Agreement on Agriculture (where Canada was found to bear the burden of proof, see para. 7.34), under Article 3 of the SCM Agreement, the usual rules on burden of proof apply.

regard to whether the measure in question is a prohibited subsidy". Article 4 also imposes a time-frame that is stricter than the usual DSU time-frame for the settlement of disputes. These shorter time periods may also be advantageous to defending parties in that their situation will need to be clarified more rapidly.

7.140 However, in this case the United States never invoked or even referred to the rules and procedures contained in Article 4. It did not do so in its request for consultations, in its request for a panel or in any of its submissions before the Panel, nor did it at any stage in this dispute pursue the matter within the framework of Article 4. Given that the United States – and, as a result, also Canada and the Panel – did not at any point proceed under Article 4, we consider it inappropriate at this stage – given also our earlier findings of violation of the Agreement on Agriculture – to further pursue the US claim under Article 3.

7.141 On the grounds set out above⁵¹⁹, and in view of the particular circumstances of this case, we thus conclude that we should apply the principle of judicial economy and, therefore, do not examine Article 3 of the SCM Agreement.

C. THE TARIFF-RATE QUOTA FOR FLUID MILK

1. Facts and claims of the parties

7.142 In Part I of Canada's Schedule to GATT 1994, Canada established a tariff-rate quota for fluid milk (HS 0401.10.10 and 0401.20.10) of 64,500 tonnes. In-quota imports are subject, initially, to a maximum duty of 17.5 per cent (a rate to be decreased to 7.5 per cent in 2001). Fluid milk imports outside of the 64,500 tonnes tariff-rate quota bear an initial rate of duty equal to 283.8 per cent, declining to 241.3 per cent in 2001. In its Schedule, Canada specified under "Other terms and conditions" that "[t]his quantity [64,500 tonnes] represents the estimated annual cross-border purchases imported by Canadian consumers".

7.143 Referring to its Schedule, Canada currently restricts access to the tariff-rate quota to cross border imports by Canadians of consumer packaged milk for personal use, valued at less than C\$20 per entry. Such imports are made under the authority of the General Import Permit No.1 issued under the Export and Import Permits Act. For such imports, no individual permits are required and no duty is being imposed, not even the in-quota duty. Moreover, the quantity of these imports is not monitored so that it is not known whether the tariff-rate quota is actually filled or not, or exceeded. Commercial shipments of milk are not allowed under the tariff-rate quota.

7.144 The United States claims that by confining the scope of fluid milk entries that are eligible under the tariff-rate quota to cross border imports by Canadians of consumer packaged milk for personal use valued at less than C\$20 per entry, Canada grants imports of fluid milk treatment less favourable than that provided for in Canada's Schedule and, thus, acts inconsistently with its obligations under Article II:1(b) of GATT 1994. The United States further claims that because Canada administers the tariff-rate quota through a general permit restricting any single import entry to a value of C\$20 and subjects such entries to a personal use restriction, Canada's licensing procedures introduce additional trade impediments that are inconsistent with its obligations under Article 3 of the Agreement on Import Licensing Procedures ("the Licensing Agreement").

7.145 Canada responds that the limited access to the tariff-rate quota is provided for in its Schedule, read in light of its negotiating history, and that, accordingly, Article II:1(b) of GATT 1994 is complied with. Canada argues that since no restrictions are placed on imports that are additional to

⁵¹⁹ See paras. 7.138-7.140.

the terms and conditions incorporated in Canada's Schedule, Canada's import regime is in complete compliance with the Licensing Agreement.

2. Article II:1(b) of GATT 1994

7.146 Article II:1(b) of GATT 1994 provides:

"The products described in Part I of the Schedule relating to any contracting party, which are the products of territories of other contracting parties, shall, on their importation into the territory to which the Schedule relates, and subject to the terms, conditions or qualifications set forth in that Schedule, be exempt from ordinary customs duties in excess of those set forth and provided therein".⁵²⁰

This provision needs to be read in the context of Article II:1(a) of GATT 1994 which states:

"Each contracting party shall accord to the commerce of the other contracting parties treatment no less favourable than that provided for in the appropriate Part of the appropriate Schedule annexed to this Agreement".⁵²¹

7.147 The 64,500 tonnes tariff-rate quota established in Part I of Canada's Schedule can thus only be subject to the 17.5 per cent (in 2001, 7.5 per cent) duty rate set out in Canada's Schedule. Any other "terms, conditions or qualifications" with respect to the access to this tariff-rate quota need to be set forth in Canada's Schedule. In this dispute, two "conditions" effectively imposed by Canada are at issue:

- (a) the fact that only consumer packaged milk for personal use can fall within the tariff-rate quota; and
- (b) the fact that only entries valued at less than C\$20 qualify for the tariff-rate quota.

7.148 The only "terms, conditions or qualifications" set forth in Canada's Schedule are contained in the following phrase, mentioned under "Other terms and conditions", next to the quota quantity of 64,500 tonnes:

"This quantity represents the estimated annual cross-border purchases imported by Canadian consumers".

If we were to find that this phrase does *not* include the two conditions currently imposed by Canada, Canada would be in violation of Article II:1(b). Our finding on the US claim of violation of Article II:1(b) thus depends on the interpretation we give to this phrase.

7.149 On the interpretation of a particular term in a Member's Schedule, the Appellate Body in its report on *European Communities – Customs Classification of Certain Computer Equipment*, stated as follows:

"84. ... Tariff concessions provided for in a Member's Schedule - the interpretation of which is at issue here - are reciprocal and result

⁵²⁰ Underlining added.

⁵²¹ Underlining added.

from a mutually-advantageous negotiation between importing and exporting Members. A Schedule is made an integral part of the GATT 1994 by Article II:7 of the GATT 1994. Therefore, the concessions provided for in that Schedule are part of the terms of the treaty. As such, the only rules which may be applied in interpreting the meaning of a concession are the general rules of treaty interpretation set out in the Vienna Convention.

85. Pursuant to Article 31(1) of the *Vienna Convention*, the meaning of a term of a treaty is to be determined in accordance with the ordinary meaning to be given to this term in its context and in the light of the object and purpose of the treaty [the Appellate Body then quotes Articles 31(2) to (4)].

86. The application of these rules in Article 31 of the *Vienna Convention* will usually allow a treaty interpreter to establish the meaning of a term. However, if after applying Article 31 the meaning of the term remains ambiguous or obscure, or leads to a result which is manifestly absurd or unreasonable, Article 32 allows a treaty interpreter to have recourse to:

... supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion.

With regard to "the circumstances of [the] conclusion" of a treaty, this permits, in appropriate cases, the examination of the historical background against which the treaty was negotiated".⁵²²

7.150 Accordingly, we need to examine first the ordinary meaning to be given to the relevant terms in Canada's Schedule in their context and in the light of the object and purpose of GATT 1994.

7.151 The phrase "[t]his quantity represents the estimated annual cross-border purchases imported by Canadian consumers" is mentioned under the heading "Other terms and conditions", next to the quota quantity. Even though one can thus presume that this phrase includes certain "terms and conditions" related to the tariff-rate quota, we find it difficult to read specific access restrictions into this phrase. The words "[t]his *quantity represents the estimated annual ...*"⁵²³ are, in our view, introducing "terms" related to the *quantity* of the quota – i.e., describing the way the size of the quota was determined – rather than setting out "conditions" as to the *kind* of imports qualified to enter Canada under this quota. In particular, the ordinary meaning of the word "represent" in this context does not, in our view, call to mind the setting out of specific restrictions or conditions.⁵²⁴

7.152 Even if the phrase could be said to include restrictions on access to the tariff-rate quota, we do not see how the two conditions *at issue in this dispute* could be read into this phrase. First, the restriction that only entries valued at less than C\$20 qualify for the tariff-rate quota can nowhere be found in Canada's Schedule. Nowhere is any reference made to a maximum value per entry. Second,

⁵²² Adopted on 5 June 1998, WT/DS62/AB/R, paras. 84-86, underlining added.

⁵²³ Emphasis added.

⁵²⁴ The *New Shorter Oxford English Dictionary*, for example, defines "represent", as used in this context, as: "1. Bring into the presence of someone or something ... 2. Bring clearly and distinctly to mind, esp. by description or imagination ... 5. ... b. Of a quantity: indicate or imply (another quantity) ..." (Ed. Brown, L., Clarendon Press, Oxford, Volume 2, p. 2552).

the requirement that only consumer packaged milk for personal use can fall within the tariff-rate quota, could only be referred to in the words "cross-border purchases imported by Canadian consumers". One could interpret these terms as restricting access to Canadians only (as opposed to, e.g., US citizens or residents) who make cross-border purchases. However, in our view, the ordinary meaning of the words "cross-border purchases" by "consumers" in this context does not warrant the conclusion that only *consumer packaged milk for personal use* can enter under the tariff-rate quota. An imported good, by definition, crosses a border. Also, the dictionary meaning of "consumer" is not restricted to a person buying *for personal use in small retail packages*. All dictionary definitions of "consumer" referred to by the parties include wider definitions without these restrictions.⁵²⁵

7.153 We find support for our view that the two access restrictions at issue here are not set forth in Canada's Schedule when comparing the phrase in dispute to other "terms and conditions" specified in Canada's Schedule, in particular those in the field of milk and dairy products which are part of the immediate context of the phrase we need to interpret. With respect to the tariff-rate quota for cream, under "Other terms and conditions", the far more precise and mandatory phrase "sterilized cream, minimum 24 per cent butterfat, in cans of a volume not exceeding 200 ml" is added. For the tariff-rate quotas established for yoghurt and ice cream, the following is added: "access for yoghurt [ice cream] in retail sized containers only". No such restrictive language can be found in the phrase at issue here.

7.154 In this respect, we also refer to the object and purpose of Article II of GATT 1994, namely "to preserve the value of tariff concessions negotiated by a Member with its trading partners, and bound in that Member's Schedule. Once a tariff concession is agreed and bound in a Member's Schedule, a reduction in its value by the imposition of duties in excess of the bound tariff rate would upset the balance of concessions among Members"⁵²⁶; as well as to the object and purpose of the WTO Agreement, generally, and of GATT 1994, namely "the security and predictability of the reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade".⁵²⁷ We cannot read the access restrictions imposed by Canada in its current Schedule. The principles of security and predictability, as well as those of treaty interpretation, do not "condone the imputation into a treaty of words that are not there or the importation into a treaty of concepts that are not intended".⁵²⁸

7.155 On these grounds, we consider that the meaning of the terms at issue can be established by examining their ordinary meaning in their context and in the light of the object and purpose of GATT 1994. In accordance with the rules of treaty interpretation referred to above⁵²⁹, we see no need to also examine the historical background against which these terms were negotiated. We do note, however, that the drafting history of the relevant part of Canada's Schedule is inconclusive, possibly supporting both the view of Canada and that of the United States.⁵³⁰

⁵²⁵ The *New Shorter Oxford English Dictionary*, for example, defines "consumer" as "1. A person who or thing which squanders, destroys, or uses up. 2. A user of an article or commodity, a buyer of goods or services. Opp. *producer*" (Ed. Brown, L., Clarendon Press, Oxford, Volume 1, p. 490). The *Black's Law Dictionary*, referred to by Canada, defines "consumer" as: "Individuals who purchase, use, maintain, and dispose of products and services ... Consumers are to be distinguished from manufacturers (who produce goods) and wholesalers and retailers (who sell goods). A buyer (other than for the purpose of resale) of any consumer product" (West Publishing Co., Minneapolis Minn., 1990).

⁵²⁶ Appellate Body report on *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel, and Other Items*, adopted on 27 March 1998, WT/DS56/AB/R, para. 47.

⁵²⁷ Appellate Body report on *European Communities – Customs Classification of Certain Computer Equipment*, op. cit., para. 82.

⁵²⁸ Appellate Body report on *India – Patent Protection for Pharmaceutical and Agricultural Chemicals*, adopted on 19 December 1997, WT/DS50/AB/R, para. 45.

⁵²⁹ See para. 7.149.

⁵³⁰ No agreement between Canada and the United States as to whether or not the phrase in dispute includes the two access restrictions imposed by Canada, can be derived from the drafting history. Canada argues that during the Uruguay Round negotiations it

7.156 We, therefore, find that Canada, by restricting the access to the tariff-rate quota for fluid milk to (i) consumer packaged milk for personal use and (ii) entries valued at less than C\$20, acts inconsistently with its obligations under Article II:1(b) of GATT 1994.

3. The Licensing Agreement

7.157 Since we have found above that the two access restrictions imposed by Canada with respect to its tariff-rate quota for fluid milk are contrary to Canada's obligations under Article II:1(b) of GATT 1994, we see no need to examine whether in so doing Canada also violates Article 3 of the Licensing Agreement.

clearly indicated to the United States that "it intended to continue its access for US milk imported by Canadian consumers while non-consumer utilisation would continue to be blocked until equivalency was established" (Canada's oral statement at our second substantive meeting, para. 129). The United States, on the other hand, submits that the phrase at issue was added to clarify that the tariff-rate quota was a continuation of "current access" opportunities already available before the Uruguay Round negotiations; not a phrase limiting access to the quota as such. In so doing, the United States argues, Canada avoided granting the "minimum access opportunities" for products for which there are no significant imports (ranging from 3 to 5 per cent of domestic consumption) referred to in the Agreement on Modalities for the Establishment of Specific Binding Commitments under the Reform Program (MTN.TNC/W/FA, p. L.19, 20 December 1991).

VIII. CONCLUSIONS

8.1 In the light of the above findings we conclude that Canada:

- (a) through Special Milk Classes 5(d) and (e) - and this for all of the dairy products in dispute (butter, cheese and "other milk products") and for both marketing years at issue (1995/1996 and 1996/1997) - 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; and
- (b) by restricting the access to the tariff-rate quota for fluid milk to (i) consumer packaged milk for personal use and (ii) entries valued at less than C\$20, acts inconsistently with its obligations under Article II:1(b) of GATT 1994.

8.2 Since Article 3.8 of the DSU provides that "[i]n cases where there is an infringement of the obligations assumed under a covered agreement [including the Agreement on Agriculture and GATT 1994], the action is considered *prima facie* to constitute a case of nullification or impairment", we conclude that - to the extent Canada has acted inconsistently with its obligations under the Agreement on Agriculture and GATT 1994 - it has nullified or impaired benefits accruing to New Zealand and the United States under these Agreements.

8.3 We *recommend* that the Dispute Settlement Body requests Canada: (i) to bring its dairy products marketing regime into conformity with its obligations in respect of export subsidies under the Agreement on Agriculture⁵³¹; and (ii) to bring its tariff-rate quota for fluid milk into conformity with GATT 1994.

⁵³¹ In this respect, we recall our findings under Article 10.1 and Article 8 of the Agreement on Agriculture (paras. 7.117-7.134).