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

SECOND RECOURSE TO ARTICLE 21.5 OF THE DSU BY NEW ZEALAND AND THE UNITED STATES

AB-2002-6

Report of the Appellate Body

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Concerning Meat and Meat Products

WORLD TRADE ORGANIZATION
APPELLATE BODY

Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products
Second Recourse to Article 21.5 of the DSU by New Zealand and the United States

Canada, *Appellant*
New Zealand, *Appellee*
United States, *Appellee*
Argentina, *Third Participant*
Australia, *Third Participant*
European Communities, *Third Participant*

AB-2002-6

Present:

Baptista, Presiding Member
Sacerdoti, Member
Taniguchi, Member

I. Introduction

1. Canada appeals certain issues of law and legal interpretations in the Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States* (the "Panel Report").[1] The Panel was established to consider a complaint by New Zealand and the United States that certain measures taken by Canada to comply with the recommendations and rulings of the Dispute Settlement Body (the "DSB") in *Canada – Dairy*[2] are not consistent with Canada's obligations under the *Agreement on Agriculture* and the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*").

2. In *Canada – Dairy*, the original panel and the Appellate Body found, *inter alia*, that Canada provided, through Special Milk Classes 5(d) and 5(e), "export subsidies" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. The original panel and the Appellate Body also found that Canada provided these export subsidies in excess of the quantity commitment levels specified in its Schedule to the *General Agreement on Tariffs and Trade 1994* (the "Schedule") and that, therefore,

[1] WT/DS103/RW2, WT/DS113/RW2, 26 July 2002. In this Report, we refer to the panel that considered the second recourse to Article 21.5 of the DSU by New Zealand and the United States—and whose findings are the subject of this appeal—as the "Panel".

[2] The recommendations and rulings of the DSB resulted from the adoption, by the DSB, of the panel report in *Canada – Dairy*. In this Report, we refer to the panel that considered the original complaint brought by New Zealand and the United States as the "original panel".

Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*. On 27 October 1999, the DSB adopted the original panel and Appellate Body reports.

3. On 23 December 1999, pursuant to Article 21.3(b) of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU"), Canada, New Zealand, and the United States agreed that the reasonable period of time for Canada to implement the recommendations and rulings of the DSB would expire on 31 December 2000.[3] On 11 December 2000, the parties agreed to extend this period of time until 31 January 2001.[4]

4. Canada subsequently adopted certain measures with a view to implementing the recommendations and rulings of the DSB. These measures are described in Section II of this Report. Taking the view that certain of these measures were not consistent with Canada's obligations under the *Agreement on Agriculture* and the *SCM Agreement*, New Zealand and the United States requested, on 16 February 2001, that the matter be referred to a panel pursuant to Article 21.5 of the DSU.[5]

5. On the same day, New Zealand and the United States also requested authorization from the DSB to suspend concessions and other obligations, as provided for in Article 22.2 of the DSU.[6] Canada objected to the level of suspension proposed and the matter was referred to arbitration, pursuant to Article 22.6 of the DSU.[7] However, the parties agreed to request the arbitrator to suspend its work pending the outcome of the Article 21.5 proceedings.[8]

6. The panel in *Canada – Dairy (Article 21.5 – New Zealand and US)*[9] found that Canada provided, through its "commercial export milk" ("CEM") mechanism, "export subsidies" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. The panel also found that Canada provided these export subsidies in excess of the quantity commitment levels specified in its Schedule and that, therefore, Canada had acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*. The Appellate Body reversed the panel's findings on the grounds that the panel had erred in its interpretation of Article 9.1(c). The Appellate Body held that the appropriate standard, in those proceedings, for determining whether "payments" are made under Article 9.1(c), is

[3]WT/DS103/10, WT/DS113/10, 7 January 2000.

[4]WT/DS103/13, WT/DS113/13, 13 December 2000.

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not, as held by the first Article 21.5 panel, the domestic price, but rather the producer's costs of production. However, in the light of the factual findings made by the first Article 21.5 panel, the Appellate Body was unable to determine whether the implementation measures involved such "payments" and, hence, export subsidies within the meaning of Article 9.1(c). Consequently, the Appellate Body was also unable to determine whether these measures were consistent with Articles 3.3 and 8 of the *Agreement on Agriculture*.[10]

7. On 6 December 2001, before adoption of the panel and Appellate Body reports in the first Article 21.5 proceedings[11], New Zealand and the United States requested the establishment of a second Article 21.5 panel. They maintained that the measures taken by Canada to comply with the recommendations and rulings of the DSB of 27 October 1999, that is, the same measures at issue in the first Article 21.5 proceedings, were inconsistent with Canada's obligations under the *Agreement on Agriculture*.[12]

8. On 18 December 2001, Canada, New Zealand, and the United States agreed that the arbitration previously requested by Canada under Article 22.6 of the DSU would remain suspended pending the outcome of the second Article 21.5 proceedings.[13] The parties also agreed that New Zealand and the United States would request that the work of the Panel be suspended pursuant to Article 12.12 of the DSU until 18 February 2002.[14]

9. In the Panel Report, circulated to Members of the World Trade Organization (the "WTO") on 26 July 2002, the Panel concluded that:

> … Canada, through the CEM scheme and the continued operation of Special Milk Class 5(d), has acted inconsistently with its obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, by providing export subsidies within the meaning of Article 9.1(c) of the *Agreement on Agriculture*

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The Panel recommended that the DSB request Canada "to bring its dairy products marketing regime into conformity with its obligations in respect of export subsidies under the *Agreement on Agriculture*."[16]

10. On 23 September 2002, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and certain legal interpretations developed by the Panel, pursuant to Article 16.4 of the DSU, and filed a Notice of Appeal pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*").[17] On 3 October 2002, Canada filed its appellant's submission.[18] On 18 October 2002, New Zealand and the United States each filed an appellee's submission.[19] On the same day, Argentina and the European Communities each filed a third participant's submission.[20] On the same day, Australia notified the Appellate Body Secretariat that, although it would not file a written submission, it intended to participate at the oral hearing.[21]

11. The oral hearing in the appeal was held on 31 October 2002. The participants and Argentina, Australia, and the European Communities presented oral arguments and responded to questions put to them by the Members of the Division hearing the appeal.

II. Background

12. The original panel found, *inter alia*, and the Appellate Body upheld, that Canada provided, through Special Milk Classes 5(d) and 5(e), "export subsidies" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*. It was also found that these subsidies were being provided for quantities of exports that exceeded the quant[illegible]

13. By way of implementation, Canada abolished Special Milk Class 5(e) and restricted export subsidies under Special Milk Class 5(d) to its commitment levels.[23] At the same time, Canada

return for their labour and investment".[29] Further, returns to family labour, management, and owner's equity are derived from the profits of the dairy enterprise. Canada asserts that profits are distinct from costs and are, therefore, excluded from the cost of production determination.

20. Third, Canada maintains that marketing, transport, and administrative costs are not production costs and, therefore, should not be included in the cost of production determination. Canada also disagrees with the Panel's finding that the costs of acquiring quota should be included in the cost of production determination. Quota costs should be treated as marketing costs confined to the domestic market and not as relevant in examining export sales. Moreover, Canada considers that quota is an intangible asset with an indefinite useful life and therefore disagrees with the Panel's conclusion that Generally Accepted Accounting Principles ("GAAP") permit amortization of quota costs.

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governmental action". Canada argues that, as the Appellate Body said, the Canadian government does not *oblige* or *drive* producers to produce and sell CEM.[31]

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B. *Written Arguments of New Zealand – Appellee*

1. Article 10.3 of the *Agreement on Agriculture*—Rules of Evidence

26. New Zealand argues that, if the Panel did not apply the burden of proof rules as set forth in Article 10.3, this was to Canada's advantage, because Canada was relieved from a burden it would otherwise have borne. Furthermore, the Panel's analysis "makes clear" that the Panel *did* require

30. Third, New Zealand submits that Canada's complaint about the Panel's treatment of transport and marketing costs, as well as of quota costs, is also without merit. All these costs, according to New Zealand, are costs incurred by the producers that must be recouped in the sales price. Describing costs as "marketing" costs, rather than "production" costs, does not alter this fact. New Zealand also

expand the scope of that provision. New Zealand also agrees with the Panel that IREP imports are available to export processors on commercially less favourable terms than CEM.

C. *Written Arguments of the United States – Appellee*

1. Article 10.3 of the *Agreement on Agriculture*—Rules of Evidence

35. The United States argues that Canada's objection to the Panel's interpretation of Article 10.3 overlooks the fact that the Panel's approach could only serve to benefit Canada, since the Panel unnecessarily examined initially whether the complainants had made out a *prima facie* case. However, the United States is of the view that this additional step did not change the outcome of the dispute.

2. Article 9.1(c) of the *Agreement on Agriculture*—"Payments Financed by Virtue of Governmental Action"

(a) "Payments"

36. The United States opines that the Panel properly concluded that Canadian milk producers are making "payments" to Canadian milk processors. First, the United States submits that the Panel correctly found that the Appellate Body, in the first Article 21.5 proceedings, did not intend an individual cost of production standard and that a cost of production benchmark based on individual producers was "unworkable".[36]

37. Second, the United States agrees with the Panel that all economic costs should be included in the cost of production benchmark. With respect to imputed costs, the Panel correctly recognized that

a production quota represents a real cost that a producer will incur in the production of milk, regardless of its treatment under accounting principles.

39. Finally, the United States submits that the Panel correctly found that Canada's individual producer data does not establish that producers are not making "payments" to processors. Canada was unable to provide evidence correlating individual producer's costs of production with sales by each producer in the CEM market, and the Panel correctly declined to assume that only those producers with costs of production below the CEM price participate in the CEM market.

(b) "Financed by Virtue of Governmental Action"

40. The United States argues that Canada's objections to the Panel's findings with respect to the phrase "financed by virtue of governmental action" are without merit. The United States disagrees with Canada's apparent contention that the Appellate Body has already ruled on the governmental action element of Article 9.1(c). The Appellate Body did not find that Article 9.1(c) requires that producers be "obliged" or "driven" to produce additional milk for export.

41. In the United States' view, the Appellate Body explained, in the first Article 21.5 proceedings, that relevant governmental action could include the regulation of the supply and price of milk in the domestic market. The Panel then rightly concluded that a profit-maximizing milk producer will

44. Finally, the United States believes that Canada mischaracterizes the Panel's analysis of Canada's regulation of the domestic supply and price of milk. The Panel did not create any new form of subsidization or new WTO obligation; rather, the Panel "carefully" followed the Appellate Body's guidance in this regard and used the term "cross-subsidization" as a convenient shorthand expression in its analysis of the governmental action in the form of the regulation of the domestic price and supply of milk.[37] The United States asserts that the Panel carefully considered whether the domestic regulated price allowed producers to engage in less remunerative CEM sales, while at least covering their marginal costs of production.

3. Article 10.1 of the *Agreement on Agriculture*—"Export Subsidies"

45. According to the United States, the Panel correctly found that Canada's CEM scheme is inconsistent with Article 10.1 of the *Agreement on Agriculture*. Contrary to Canada's allegations, the Panel did not overlook relevant context in applying item (d) of the Illustrative List of the *SCM Agreement*. Furthermore, the United States agrees with the Panel that Canadian milk processors obtain CEM at more favourable terms than whole milk powder through IREP.

D. *Written Arguments of the Third Participants*

1. Argentina

46. Argentina agrees broadly with the Panel's reasoning under Article 9.1(c) and considers that, given the characteristics of the Canadian milk supply system—as discussed by the Panel—,Canadian producers will channel their surplus production into the CEM market. Argentina also submits that the use of the phrase "by virtue of", rather than of the word "by", indicates that Article 9.1(c) covers circumstances where "payments" are not financed directly by government, and where government does not intervene directly in the provision of "payments", but nevertheless creates "a whole set of circumstances" that ultimately lead to "payments" on exports.[38]

47. As regards Article 10.1 of the *Agreement on Agriculture*, Argentina concurs with the Panel that Canada failed to establish the absence of the three elements of export subsidies contemplated by item (d) of the Illustrative List of the *SCM Agreement*. A governmental measure that falls under item (d) of the Illustrative List of the *SCM Agreement* is, at the same time, an "export subsidy" within the meaning of Article 10.1, even if no charge on the public account is involved.

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[37] United States' appellee's submission, para. 61.

[38] Argentina's third participant's submission, para. 26.

2. European Communities

48. The European Communities agrees with Canada that the Panel incorrectly interpreted Article 10.3 of the *Agreement on Agriculture.* The correct standard of proof to be applied in this case is that Canada should make out a *prima facie* case to establish that its measure does not constitute an "export subsidy".

49. With respect to the issue of "payments" under Article 9.1(c) of the *Agreement on Agriculture*, the European Communities considers that the average total cost of production is not the appropriate benchmark for assessing whether there are "payments" within the meaning of Article 9.1(c). The Panel's standard makes it possible to find a subsidy where no "benefit" is provided and, in any event, the standard is "unworkable".[39] The Panel also erred in including in the cost of production standard an amount for profit as well as cost items such as family labour, return on management, and return on equity. Finally, in examining the evidence of "payments", the Panel imposed an insurmountable burden of proof on Canada.

50. With respect to the phrase "financed by virtue of governmental action", the European Communities "fully supports" Canada's appeal.[40] The Panel applied a standard that contradicts the Appellate Body's guidance in that the Panel found that it was sufficient to show that governmental action makes sales possible. None of the four governmental actions identified by the Panel—that is, prohibition on diversion of CEM into the domestic market; the exemption of export processors from paying the fixed domestic price; cross-subsidization; and the pre-commitment requirement—is sufficient to establish that producers are obliged or driven to provide CEM.

51. The European Communities opines that the Panel added to the obligations under Article 9.1(c) of the *Agreement on Agriculture.* An interpretation of the term "financed" as also covering payments-in-kind goes beyond the ordinary meaning of the term. Article 9.1(c) includes private party payments only to the extent that "payments" are financed from the proceeds of a levy imposed on the agricultural product concerned. Accordingly, the European Communities submits that, for a measure to fall under Article 9.1(c), the government must "impose" or "mandate" payments.[41]

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[39] European Communities' third participant's submission, title of section IV.A.1 (b), p. 12.

[40] *Ibid.*, para. 67.

[41] *Ibid.*, title of section IV.B.4 (b), p. 25.

52. The European Communities further contends that the Panel's findings are based on the assumption that WTO Members intended to prevent cross-subsidization, that is, that WTO Members intended to target the *omission* of governments to prevent the "natural economic behaviour" of cross-subsidization.[42] However, Article 9.1(c), like all WTO law, is concerned only with governmental *actions*, not also with governmental *omissions*.

53. The European Communities disagrees with the Panel's findings on Article 10.1 of the *Agreement on Agriculture*. The notion of an export subsidy under this provision must be read "co-extensively"[43] with the basic definition of subsidies under the *SCM*

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V. Article 10.3 of the *Agreement on Agriculture*—Rules of Evidence

55. At the outset of its findings, the Panel considered the significance of Article 10.3 of the *Agreement on Agriculture* for these proceedings. The Panel noted that the parties were in agreement that, under Article 10.3, Canada—the responding Member—bears the burden of proof.[44] Accordingly, the Panel opined that, if the complaining Members demonstrated "that Canada has exceeded its export subsidy reduction commitment levels on certain dairy products", it would be for Canada to establish that it is not providing export subsidies in relation to the exports exceeding its commitment levels.[45] In that respect, the Panel stated that:

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57. Canada considers that the Panel erred by requiring the complaining Members to make out a *prima facie* case of their claims. In consequence, Canada argues that the Panel failed properly to apply the burden of proof. Canada asserts that Article 10.3:

> … sets out a reverse burden of proof, which … requires the respondent to establish a rebuttable presumption that its measures are not inconsistent. It is then up to the complainant to present evidence and argument that rebuts this presumption.[47]

58. In its appeal, Canada submits that the original panel in *Canada – Dairy*[48] correctly interpreted Article 10.3.

59. In the original panel proceedings, the panel made the following remarks on Article 10.3:

> 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.[49] (emphasis added; footnote omitted)

60. The original panel did not require the complaining Member to make out a *prima facie* case; that is, the second step above was not included in the reasoning. Instead, the original panel read Article 10.3 as allocating the burden of proof to the responding Member to demonstrate that no subsidies were provided for exports exceeding the commitment levels (that is, the third step above).[50]

61. In the first Article 21.5 proceedings, the panel expressed a very similar view, opining that "when reduction commitments have been exceeded, Article 10.3 has the effect of reversing the usual burden of proof ".[51] That panel did not require the complaining Members to make out a *prima facie* case of the elements of the claimed export subsidy.

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[47]Canada's appellant's submission, para. 31.

[48]In this Report, we refer to the panel that considered the original complaint brought by New Zealand and the United States as the "original panel".

[49]Panel Report, *Canada – Dairy*, para. 7.33.

[50]The original panel also established that Canada had exported dairy products in quantities exceeding the quantity commitment level (that is, the first step above). (*Ibid.*, para. 7.34)

[51]Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 6.3.

62. The meaning of Article 10.3 of the *Agreement on Agriculture* was also addressed in the original proceedings in *US – FSC*. In that dispute, the panel considered it "evident" that Article 10.3 "shifts" or, as it also said, "reverses", the usual rule that the burden of proof is on the complaining Member to establish its claims.[52] That panel also made no mention of any requirement for the complaining Member to make out a *prima facie* case of the elements of the claimed export subsidy.

63. Although Article 10.3 of the *Agreement on Agriculture* has been examined by several panels, this is the first time that we examine the interpretation of this provision.

64. Before addressing Article 10.3, it is useful to recall our view of the burden of proof as a general matter. This issue was first examined in *US – Wool Shirts and Blouses*, where we stated that:

> … various international tribunals, including the International Court of Justice, have generally and consistently accepted and applied the rule that the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof. Also, it is a generally-accepted canon of evidence in civil law, common law and, in fact, most jurisdictions, that the burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what is claimed is true, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut the presumption.[53] (footnotes omitted)

65. In *EC – Hormones*, we said:

> The initial burden lies on the complaining party, which must establish a *prima facie* case of inconsistency with a particular provision of the *SPS Agreement* on the part of the defending party, or more precisely, of its SPS measure or measures complained about. When that *prima facie* case is made, the burden of proof moves to the defending party, which must in turn counter or refute the claimed inconsistency.[54]

66. Thus, we have consistently held that, as a general matter, the burden of proof rests upon the complaining Member. That Member must make out a *prima facie* case by presenting sufficient evidence to raise a presumption in favour of its claim. If the complaining Member succeeds, the responding Member may then seek to rebut this presumption. Therefore, under the usual allocation of the burden of proof, a responding Member's measure will be treated as WTO-*consistent*, until

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[52]Panel Report, *US – FSC*,

sufficient evidence is presented to prove the contrary. We will not readily find that the usual rules on burden of proof do not apply, as they reflect a "canon of evidence" accepted and applied in international proceedings.

67. Article 10.3 of the *Agreement on Agriculture* reads:

> *Prevention of Circumvention of Export Subsidy Commitments*
>
> …
>
> 3. 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. (emphasis added)

68. This provision requires that a specific Member, in defined circumstances, "establish that no export subsidy … has been granted". We begin by identifying the specific Member and circumstances to which Article 10.3 applies. The provision refers to a Member making a "claim" that certain exports are "*not* [being] subsidized". Although the word "claim" usually refers to an assertion by a complaining Member that a measure is WTO-*inconsistent*, in this provision the word "claim"

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the commitment. The commitment is an undertaking to limit the quantity of exports that may be *subsidized* and not a commitment to restrict the volume or quantity of exports *as such*. The second part of the claim is, therefore, that the responding Member must have granted export subsidies with respect to quantities exceeding the quantity commitment level. There is, in other words, a *quantitative* aspect and an *export subsidization* aspect to the claim.

71. Under the usual rules on burden of proof, the complaining Member would bear the burden of proving both parts of the claim. However, Article 10.3 of the *Agreement on Agriculture* partially alters the usual rules. The provision cleaves the complaining Member's claim in two, allocating to different parties the burden of proof with respect to the two parts of the claim we have described.

72. Consistent with the usual rules on burden of proof, it is for the complaining Member to prove the first part of the claim, namely that the responding Member has exported an agricultural product in quantities that exceed the responding Member's quantity commitment level.

73. If the complaining Member succeeds in proving the quantitative part of the claim, and the responding Member contests the export subsidization aspect of the claim, then, under Article 10.3, the responding Member "*must establish* that no export subsidy … has been granted" in respect of the excess quantity exported. (emphasis added) The language of Article 10.3 is clearly intended to alter the generally-accepted rules on burden of proof. The verb "establish" is synonymous with the verbs "demonstrate" and "prove".[56] Moreover, the auxiliary verb "must" conveys that the responding Member has an obligation—or legal burden—to "establish" or "prove" that "no export subsidy … has

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concluded that Canada "failed to establish" that CEM did not involve export subsidies.[60] We will examine, below, the appeals that Canada makes against this finding under Articles 9.1(c) and 10.1 of the

81. Before the Panel, the parties disagreed as to how the average total cost of production standard (the "COP standard") should be determined. The Panel "doubted" that Canada was correct to argue that the standard should be each *individual* producer's costs of production, rather than a single *industry-wide* average figure, as proposed by the complaining Members.[65] The Panel also found that

"cannot possibly be expected to meet".[70] Before examining these four arguments, we provide general observations relating to Article 9.1(c).

1. General Remarks on Article 9.1(c) of the *Agreement on Agriculture*

85. The word "payment", in Article 9.1(c) of the *Agreement on Agriculture*, denotes a "transfer of economic resources".[71] Although a monetary payment certainly involves such a transfer, the same is equally true where goods or services are transferred for less than full value. Recognizing this, we upheld the original panel's finding that the ordinary meaning of the word "payment", in Article 9.1(c) of the *Agreement on Agriculture*, "encompasses 'payments' made in forms other than money".[72]

86. In these second Article 21.5 proceedings, New Zealand and the United States assert that non-monetary "payments" are effected through the supply of goods—CEM. The issue is, therefore, whether supplies of CEM, by Canadian producers, involve a transfer of economic resources to processors.

87. In examining this question in the first Article 21.5 proceedings, we took into account that Article 9.1(c) of the *Agreement on Agriculture* describes an unusual form of subsidy in that "payments" can be made by private parties, and need not be made by government.[73] Moreover, "payments" need not be funded from government resources, provided they are "financed by virtue of governmental action".[74] Article 9.1(c), therefore, contemplates that "payments" may be made and funded by private parties, without the type of governmental involvement ordinarily associated with a subsidy. Furthermore, the notion of payments encompasses a diverse range of practices involving monetary transfers, or transfers-in-kind. We, therefore, determined that, in identifying whether "payments" are made, it is necessary to consider the particular features of the alleged "payments", by whom they are made, and in what circumstances. Thus, we found that the standard for determining the existence of "payments" under Article 9.1(c) must be identified after careful scrutiny of the factual and regulatory setting of the measure.[75]

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[70] Canada's appellant's submission, para. 47.

[71] Appellate Body Report, *Canada – Dairy*, para. 107.

[72] *Ibid.*, para. 112.

[73] Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 113 and 115.

[74] *Ibid.*, para. 114.

[75] *Ibid.*, para. 76.

88. In the case of CEM, we took into account the fact that the alleged "payments" are made by private parties through the supply of milk. Moreover, subject to the requirement to pre-commit sales of CEM, the private parties are entirely free to produce milk for sale as CEM, and it is for them to agree the price, volume, and timing of the sale with the buyers.[76] In these particular circumstances, we considered that the determination of whether "payments" are made depends on a comparison between the price of CEM and an "objective standard or benchmark which reflects the proper value of the [milk] to [its] provider".[77] We found that, in the circumstances of this dispute, the standard for determining the proper value of CEM is the average total cost of production of the milk (the COP standard), as this standard represents the economic resources the producer invests in the milk. If CEM is sold at less than its proper value, "payments" are made, because there is a transfer of the portion of economic resources not reflected in the selling price.

89. We also provided certain guidance on the determination of the COP standard:

> The average total cost of production would be determined by dividing the fixed and variable costs of producing *all* milk, whether destined for domestic or export markets, by the total number of units of milk produced for both these markets.[78] (original italics)

90. With these general observations in mind, we turn to Canada's four primary arguments on "payments".

2. Individual Producer's Costs of Production or Industry-wide Average

91. Canada argues that the Panel erred in considering that the COP standard is a single, *industry-wide* average cost of production figure, rather than each *individual* producer's costs of production.[79]

92. Although the Panel expressed "doubts" that the COP standard should be each individual producer's costs, rather than an industry-wide figure, we note that it did not reach a definitive view on

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[76]In response to questioning at the oral hearing, Canada affirmed us that pre-commitment of CEM sales must be made at least 30 days in advance of the sale date.

[77]Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 74.

[78]*Ibid.*) 78

this question.[80] Instead, as we said, the Panel examined the evidence from the perspective of the alternative positions, and found against Canada under each of them.[81]

93. Canada asserts that we found, in the first Article 21.5 proceedings, that the COP standard is based on individual producer's costs of production. However, this question was not specifically examined, nor resolved, in the first Article 21.5 proceedings.

94. For purposes of resolving this question, it is relevant to consider the *nature* of the obligations imposed under the *Agreement on Agriculture*. That Agreement, which is annexed to the *Marrakesh Agreement Establishing the World Trade Organization*, is an international agreement to which Canada is a party, as a sovereign State. Pursuant to this Agreement, Canada has undertaken a number of different obligations. Among these are the obligations in Articles 3.3 and 8 of the *Agreement on Agriculture* not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule. Accordingly, under Article 3.3, Canada has undertaken not to provide the export subsidies listed in Article 9.1 "in excess of … [its] quantity commitment levels".

95. However, under Article 9.1(c) of the *Agreement on Agriculture*, it is not solely the conduct of WTO Members that is relevant. We have noted that Article 9.1(c) describes an unusual form of export subsidy in that "payments" can be made and funded by private parties, and not just by government.[82] The conduct of private parties, therefore, may play an important role in applying Article 9.1(c). Yet, irrespective of the role of private parties under Article 9.1(c), the obligations imposed in relation to Article 9.1(c) remain obligations imposed on Canada. It is Canada, and not private parties, which is responsible for ensuring that it respects its export subsidy commitments under the covered agreements. Thus, under the *Agreement on Agriculture*, any "export subsidies" provided through private party action in Canada are deemed to be provided by Canada, and count towards Canada's export subsidy commitment levels.

96. We believe that the standard for determining the existence of "payments", under Article 9.1(c), should reflect the fact that the obligation at issue is an international obligation imposed on Canada. The question is not whether one or more individual milk producers, efficient or not, are selling CEM at a price above or below their individual costs of production. The issue is whether Canada, on a national basis, has respected its WTO obligations and, in particular, its commitment

[80]Panel Report, paras. 5.50 and 5.90.

[81]*Ibid.*, paras. 5.86-5.87.

[82]*Supra*, para. 87.

levels. It, therefore, seems to us that the benchmark should be a single, industry-wide cost of production figure, rather than an indefinite number of cost of production figures for each individual producer. The industry-wide figure enables cost of production data for producers, as a whole, to be aggregated into a single, national standard that can be used to assess Canada's compliance with its international obligations.

97. By contrast, if the benchmark were to operate at the level of each individual producer, there would be a proliferation of standards, requiring individual-level inquiry and application of Article 9.1(c), as if the obligations under the *Agreement on Agriculture* involved rights and obligations of individual producers, rather than WTO Members.

98. We, therefore, find that the COP standard for determining whether the sale of CEM involves "payments", under Article 9.1(c) of the *Agreement on Agriculture*, is an industry-wide average figure that aggregates the costs of production of all producers of milk.[83] Although the Panel did not express any firm view on this issue, we see no error in the Panel's treatment of this question.

3. Imputed Costs

101. In examining this issue, we recall that the notion of "payment", in Article 9.1(c), covers transfers of economic resources, irrespective of the means by which the resources are transferred. Thus, the transfer may be effected in monetary form or equally by a transfer of goods or services for less than full value.[86]

102. In these proceedings, the purpose of the COP standard is precisely to determine whether supplies of CEM involve payments-in-kind that are made in a form other than money. If the COP standard were confined solely to cash costs, as Canada argues, this would overlook the possibility of "payments" being made in the form of non-cash resources invested in the production of milk. Thus, the COP standard must cover *all* of the economic resources invested in the production of milk and which may be transferred, irrespective of whether the resources involve an actual cash cost.

103. We are satisfied that any labour or management services provided by the farmer's family to the dairy enterprise are relevant economic resources invested in the production of milk and must be included in the COP standard. For the dairy farmer, and his or her family, the investment of services in the dairy enterprise has an economic cost, as those services cannot be put to an alternative remunerative use. We observe that both the United States and New Zealand submitted evidence to the Panel in support of the view that, from the perspective of economic theory, any labour and management services provided to an enterprise involve such an economic "opportunity" cost.[87] Moreover, we believe that remuneration of family labour and management services is not part of the profits of the dairy farm. Rather, profits are the proceeds remaining after all costs, including such salary costs, have been accounted for.

profits

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105. Moreover, it would be incongruous if the costs of family labour and management were excluded from the COP standard when provided by family, but included when provided by others.[89] Likewise, it would be curious if the cost of capital, of which equity is one type, were excluded from the COP standard when capital is provided through the owner's equity, but included when it is provided through, for instance, debt, merely because the cost of debt is expressed in recurring cash outlays for interest payments. In each case, the dairy enterprise is incurring an economic cost and that cost should be appropriately reflected in the costs of production.

106. Accordingly, we find that any failure to include in the COP standard the costs of family labour and management, or of owner's equity, would understate the costs of milk production, and may lead to a non-monetary "payment" going undetected.

107. Although it is clear that the COP standard includes all economic costs, even if they are non-cash costs, we acknowledge that a specific value cannot be as readily ascribed to non-cash costs as it can to cash costs. However, we do not believe, as suggested by Canada, that this practical difficulty precludes the application of an objective COP standard.

108. In some situations, it may be appropriate for a panel to value non-monetary costs using a methodology set forth in a Member's Generally Accepted Accounting Principles ("GAAP"). In that respect, we observe that Canada did not contest the amounts the Canadian Dairy Commission (the "CDC") ascribed to depreciation using the rules in Canadian GAAP.[90] However, although GAAP provide an objective valuation methodology for some non-monetary costs, they may not address all such costs.[91] If GAAP rules do not provide an appropriate basis for valuing a particular cost, a panel should attempt to determine a value for relevant non-monetary costs using an objective methodology that is reasonable in the circumstances. Clearly, a panel must base itself on the evidence before it, applying the applicable rules on burden of proof.

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[89]We note that, according to the Canadian Dairy Commission Handbook ("*CDC Handbook*"), family labour and management is treated as an imputed, non-cash cost, "regardless of whether or not the family member is paid for his/her labour". (*CDC Handbook*, p. 26, Exhibit NZ-4 submitted by New Zealand to the Panel; Exhibit US-22 submitted by the United States to the Panel) Thus, in some cases there may be an actual cost for family labour and management which is excluded by the CDC and replaced by an imputed cost using the CDC's methodology. Canada's argument would, in fact, exclude both an actual cost incurred by the dairy enterprise and an imputed cost. We note also that the *CDC Handbook* defines a family member in broad terms to include: "the producer, the producer's spouse, children, brothers, sisters, sons-in-law, daughters-in-law and parents." (*CDC Handbook*

109. We note that New Zealand and the United States submitted evidence to the Panel in the form

producer invests in the milk as are farm-based production costs. Indeed, the costs incurred to make sales are a vital part of the process by which the producer earns revenues through producing milk. If the producer sells milk at a price sufficient to cover only the farm-based production costs, it transfers to the processor any resources invested in selling the milk, such as the value of transport, marketing, and administration. There would, in such circumstances, be a "payment" of the value of these

5. Assessment of Evidence

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Canada had not satisfied that burden.[104] We can see no error in the Panel's assessment of the evidence.[105]

6. Conclusion on "Payments" under Article 9.1(c)

121. For all these reasons, we uphold the Panel's finding, in paragraph 5.89 of the Panel Report, that the supply of CEM, by producers to processors, involves "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

B. *"Financed by Virtue of Governmental Action"*

122. We turn now to the second element of Canada's appeal of the Panel's findings under Article 9.1(c) of the *Agreement on Agriculture*—whether the Panel erred in finding that "payments", made on the sale of CEM, are "financed by virtue of governmental action".

123. The Panel recalled that there must be a "demonstrable link" between governmental action and the financing of "payments".[106] The Panel proceeded to examine several actions of the Canadian government in regulating the supply of domestic milk and CEM. It concluded that New Zealand and the United States had made out a *prima facie* case that a demonstrable link exists between these Canadian governmental actions and the financing of CEM payments. Further, the Panel found that Canada had failed to establish, pursuant to Article 10.3 of the *Agreement on Agriculture*, that these governmental actions were not demonstrably linked to the financing of the payments.[107]

124. On appeal, Canada argues that the Panel erred under Article 9.1(c) of the *Agreement on Agriculture*, in particular by finding that a "demonstrable link" exists between Canadian governmental action and the financing of CEM payments. Canada claims that it has removed government action from "every stage of the export transaction" and that producers and processors "freely choose to enter into export transactions".[108] Therefore, Canada argues that no demonstrable link exists between governmental action and financing of CEM payments.

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[104] Panel Report, para. 5.89.

[105] Pursuant to Article 11 of the DSU, a panel must make an objective assessment of the facts. As such, a panel is the trier of facts, responsible for evaluating the credibility and weight of the evidence. As we have stated, we will interfere with a panel's assessment of the evidence only if the panel has exceeded the bounds of its discretion as trier of facts. (Appellate Body Report, *US – Wheat Gluten*, para. 151)

[106] Panel Report, para 5.106, referring to Appellate Body Report, *Canada – Dairy*, para. 113.

[107] *Ibid.*, paras. 5.133-5.135.

[108] Canada's appellant's submission, paras. 74 and 101.

125. Article 9.1(c) of the *Agreement on Agriculture* provides:

> *Export Subsidy Commitments*
>
> 1. The following export subsidies are subject to reduction commitments under this Agreement:
>
> …
>
> (c) payments on the export of an agricultural product that are *financed by virtue of governmental action*, 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; (emphasis added)

126. The phrase "financed by virtue of governmental action" has three distinct elements—"governmental action"; "by virtue of"; and "financed"—which we will address in turn.

127. As regards "governmental action", we held in the first Article 21.5 proceedings that "the text of Article 9.1(c) does not place any qualifications on the types of 'governmental action' which may be relevant under Article 9.1(c)."[109] Instead, the provision gives but one example of governmental action that is "included" in Article 9.1(c)—however, this example is merely illustrative.[110] Accordingly, we stated that Article 9.1(c) "embraces the full-range" of activities by which governments "'regulate', 'control' or 'supervise' individuals".[111] In particular, we said that governmental action "regulating the supply and price of milk in the domestic market" might be relevant "action" under Article 9.1(c).[112] Moreover, the governmental action may be a single act or omission, or a series of acts or omissions.

128. We observe that Article 9.1(c) does not require that payments be financed by virtue of government "*mandate*", or other "*direction*". Although the word "action" certainly covers situations where government mandates or directs that payments be made, it also covers other situations where no such compulsion is involved.[113]

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

[110] The example 5.25.1033 b. T"inc104o954d Dairy (Article 21.5 – New Zealand Appellate Body Report,

129. Although the term "governmental action", when read in isolation, is somewhat open-ended, perhaps even abstract, the words "by virtue of " clarify further the meaning of this term. In the first Article 21.5 proceedings, we opined:

> The words "by virtue of " indicate that there must be a demonstrable link between the *governmental action* at issue and the *financing* of the payments, whereby the payments are, in some way, financed as a result of, or as a consequence of, the governmental action.[114] (original italics)

130. The words "by virtue of ", therefore, express the relationship between "governmental action" and the "financing" of payments for the purpose of Article 9.1(c). The essence of that relationship is the "nexus" or "link" between "action" and "financing".

131. Thus, although Article 9.1(c) extends, in principle, to *any* "governmental action", not every governmental action will have the requisite nexus to the financing of payments. In the first Article 21.5 proceedings, we observed that "[g]overnments are constantly engaged in regulation of different kinds in pursuit of a variety of objectives."[115] Yet, we went on to say that regulation that merely *enables* payments to occur will not suffice for those payments to be regarded as "financed by virtue of governmental action". We stated:

> [Where regulation merely enables payments to occur], the link between the governmental action and the financing of the payments is too tenuous for the "payments" to be regarded as "*financed* by virtue of governmental action" … within the meaning of Article 9.1(c). Rather, there must be a tighter nexus between the mechanism or process by which the payments are *financed* …[116] (original italics)

132. This brings us to the meaning of the word "financing". The word refers generally to the mechanism or process by which financial resources are provided to enable "payments" to be made. The word could, therefore, be read to mean that government itself must provide the resources for producers to make payments. However, Article 9.1(c) expressly precludes such a reading, as it states that "payments" need *not* involve "a charge on the public account". This is borne out by the fact that the text indicates that "financing" need only be "by virtue of governmental action", rather than "by government" itself. Article 9.1(c), therefore, contemplates that "payments may be financed by virtue

[114] Appellate Body Report,

of governmental action even though significant aspects of the financing might not involve government."[117] Indeed, as we have said, payments may be made, and funded, by private parties.[118]

133. The word "financing" must, nonetheless, be given meaning. Accordingly, even if government does not fund the payments itself, it must play a sufficiently important part in the process by which a private party funds "payments", such that the requisite nexus exists between "governmental action" and "financing".

134. These general remarks illustrate well that "[i]t is extremely difficult … to define in the abstract the precise character of the required link between the governmental action and the financing of the payments, particularly where payments-in-kind are at issue."[119] In each case, the alleged link must be examined taking account of the particular character of the governmental action at issue and its relationship to the payments made.[120]

135. With this mind, we turn to the facts of this dispute. We recall that we have described the key features of the Canadian regulatory system in paragraphs 12-14 of this Report.[121]

136. We have also upheld the Panel's finding that producers make "payments", under Article 9.1(c) of the *Agreement on Agriculture*, to processors through sales of CEM at prices that are below the COP standard. As a result, producers' sales revenues do not recoup all of the costs associated with producing and selling CEM. As this short-fall in revenues must be "financed" from some other source, sales of CEM necessarily involve the "financing" of "payments". The crucial question is the *source* of that financing and, in particular, whether the financing occurs "by virtue of governmental action".

137. The Panel considered that "a significant percentage" of Canadian milk producers are able to cover the entirety of fixed and variable costs of production through in-quota sales of domestic milk. As a result, the Panel opined, these producers can afford to make export sales at marginal cost.[122] The Panel found that governmental action regulating the domestic milk market "cross-subsidizes many sales that otherwise would not be made or would at least constitute sales at a loss."[123]

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[117]Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 114.

[118]*Supra*, para. 87.

[119]Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 115.

[120]*Ibid.*, para. 115.

[121]See also Panel Report, paras. 2.1-2.4.

[122]*Ibid.*, para. 5.128.

[123]*Ibid.*, para. 5.127.

138. We note that CEM is produced almost exclusively by the same producers who supply milk to the domestic market.[124] It is not contested that these producers use the same production facilities to produce domestic and export milk—that is, the same land, cattle, buildings, machinery, milking facilities, and so on. Indeed, in some provinces, even after production, both regulatory classes of milk have common storage and transportation facilities.[125] There is, in other words, a single line of production for all milk, whatever its destination market.

139. Where fungible goods, such as milk, are produced using a single line of production, but sold in two different markets, the fixed costs of production are, in principle, shared between sales revenues from both markets. However, in the event that one of the two markets offers much higher revenues, a disproportionately large part, possibly even all, of the shared fixed costs may be borne by sales made in the more remunerative market.

140. Where sales in the more remunerative market bear more than their relative proportion of shared fixed costs, sales in the other market do not need to cover their relative proportion of the shared fixed costs in order to be profitable.[126] Rather, these sales can be made profitably *below* the average total cost of production. If the more remunerative sales cover *all* fixed costs, sales in the other market can be made profitably at any price above marginal cost. In these situations, the higher revenue sales effectively "*finance*" a part of the lower revenue sales by funding the portion of the shared fixed costs attributable to the lower priced products.

141. In Canada, the domestic price of milk is fixed by a government agency—the CDC—on the basis of an annual survey of producers' costs of production. The CDC has a statutory mandate to ensure that, through the administered price, a "fair return" is secured for "efficient producers". The CDC sets this administered price on the basis of data covering 70 percent of producers, such that these 70 percent of producers can, on average, cover *all* of their costs of production, including *all fixed*

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costs, through domestic sales of milk.[127] Moreover, for other producers, domestic sales will cover a significant part, if not all, of the fixed costs. This suggests, to us, that a large proportion of producers can finance the sale of CEM at a price that is below the COP standard *as a result of participation in the domestic market.*[128] In that respect, we note also that the domestic milk market represents 96.4 percent, by volume, of total Canadian milk production, with export production representing only 3.6 percent, by volume.[129]

142. We observe that, although there is a large proportion of producers that could sell CEM below the COP standard, the proportion of producers who have actually made at least one CEM sale is around 40 percent of all producers.

143. In these circumstances, we agree with the Panel that the evidence indicates that a "significant percentage" of producers are "likely" to make sales of CEM at below the costs of production as a result of highly remunerative in-quota sales in the domestic market. For these producers, domestic sales are likely to "finance" payments made on the sale of CEM. Although the Panel's finding is based on "likelihood", this likelihood seems, to us, to be rather high. Any producer whose fixed costs have been, in large part, covered by domestic sales, and who has sufficient capacity to produce for the export market, has a powerful profit incentive to sell CEM at a competitive export price, even if that price is below the average total cost of production, as long as the price is above marginal costs of production. In any event, we recall that, pursuant to Article 10.3 of the *Agreement on Agriculture*, Canada bears the burden of proving that sales of CEM do not involve the granting of export subsidies.

144. It falls now to consider the role of the Canadian government in financing payments made on the sale of CEM. We have agreed with the Panel that a significant percentage of producers are likely to finance sales of CEM at below the costs of production as a result of participation in the domestic market. Canadian "governmental action" controls virtually every aspect of domestic milk supply and management.[130] In particular, government agencies fix the price of domestic milk that renders it

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[127] Panel Report, para. 5.128.

[128] In addition to the *CDC Handbook*, the Panel also referred to newspaper articles submitted by New Zealand to support its view that a significant proportion of producers covers their fixed costs through domestic sales. (Panel Report, para. 5.128; BsiIj T* bF1 9.7e

148. Canada also objects that this reasoning brings "cross-subsidization" under Article 9.1(c) of the *Agreement on Agriculture*.[133] We have explained that the text of Article 9.1(c) applies to any "governmental action" which "finances" export "payments". The text does not exclude from the scope of the provision any particular governmental action, such as regulation of domestic markets, to the extent that this action may become an instrument for granting export subsidies. Nor does the text exclude any particular form of financing, such as "cross-subsidization". Moreover, the text focuses on the consequences of governmental action ("by virtue of which") and not the intent of government. Thus, the provision applies to governmental action that finances export payments, even if this result is not intended. As stated in our Report in the first Article 21.5 proceedings, this reading of Article 9.1(c) serves to preserve the legal "distinction between the domestic support and export subsidies disciplines of the *Agreement on Agriculture*".[134] Subsidies may be granted in both the domestic and export markets, provided that the disciplines imposed by the Agreement on the levels of subsidization are respected. If governmental action in support of the domestic market could be applied to subsidize export sales, without respecting the commitments Members made to limit the level of export subsidies, the value of these commitments would be undermined. Article 9.1(c) addresses this possibility by bringing, in some circumstances, governmental action in the domestic market within the scope of the "export subsidies" disciplines of Article 3.3.

149. In our view, the nexus between the Canadian governmental actions in regulating the domestic market and the financing of payments made on the sale of CEM is sufficient, on its own, for us to uphold the Panel's finding that these payments are financed "by virtue of" governmental action. However, we note that, besides these actions, the Panel also relied on other forms of governmental action in support of its conclusion on this issue.[135] The first of these was that *processors* are exempt from paying the higher domestic price for milk when they purchase CEM.[136] We do not believe that this action influences the "financing" of payments by the producer. Certainly, this action explains why the *processor* of CEM is not *required* to pay the higher domestic price for CEM. However, the mere fact that the processor is not obliged to buy CEM at the domestic price does not demonstrate a link between this exemption and the financing of payments by the *producer* on the sale of CEM. The exemption is, in short, not linked to the mechanism by which the producer funds the payments.

[133]The Panel used this term to describe the fact that sales revenues from one market—the domestic market—finance a portion of the costs associated with sales made in another market—the CEM market. (Panel Report, paras. 5.127, 5.130, and 5.134)

[134]Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 90.

[135]Panel Report, para. 5.134.

[136]*Ibid.*, paras. 5.115-5.116.

150. The second other form of governmental action relied on by the Panel was "the prohibition on the diversion of CEM back into the domestic regulated market".[137] We have already mentioned this factor in our analysis of governmental action.[138]

151. The final governmental action relied on by the Panel was the requirement for producers to pre-commit to sell CEM. The Panel found that this requirement creates "an additional incentive" to sell a larger quantity of CEM than would be the case if producers could decide to sell to that market "*ex post*".[139] Although this may be the case, we also consider it possible that producers are able to make a reasonably accurate prediction of production levels, particularly as pre-commitment occurs on a 30-day basis.[140] Further, we think producers are just as likely to err on the side of caution to ensure that CEM sales do not prejudice their ability to exhaust their quota entitlement to sell milk at the higher domestic price. In the light of these doubts, we attach no weight to the pre-commitment requirement.

152. Before concluding, we wish to comment on Canada's arguments concerning the approximately 100 producers out of the 8,000 who sell CEM, and out of the total of 19,000 producers that do *not* participate in the domestic market at all and sell solely CEM.[141] Canada argues that the Panel erred in finding that, for these producers, sales of CEM involve payments "financed by virtue of governmental action". We do not believe that it is necessary for us to make any findings regarding these 100 producers. The complaint made by New Zealand and the United States is that Canada has acted inconsistently with its export subsidy commitments under the *Agreement on Agriculture*. Canada may act inconsistently with these commitments, as we have found, even if some producers never make payments financed by virtue of governmental action.

153. We also wish to emphasize that we do not suggest that Canada's domestic supply management system is inconsistent with Canada's obligations under the covered agreements and, specifically, the *Agreement on Agriculture.* The consistency of Canada's domestic milk supply management system is *not* at issue in these proceedings. However, pursuant to Articles 3.3, 8, and 9.1(c) of the *Agreement on Agriculture*, Canada must ensure that it confines, to its export subsidy reduction commitment levels, any export "payments" which are "financed by virtue of" the governmental action Canada takes to regulate the domestic milk market.

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[137] Panel Report, paras. 5.117 and 5.134.

[138] *Supra*, para. 144.

[139] Panel Report, para. 5.130.

[140] Canada's response to questioning at the oral hearing.

[141] See *supra*, footnote 124.

154. In conclusion, i /F1 11.orefore, we uphold11.o Panel's finding, in paragraph 5Tc 5 of11.o Panel4.75 -3

both the Panel's reasoning and its finding under Article 10.1 of the *Agreement on Agriculture* are moot and of no legal effect. There is, therefore, no reason for us to rule upon Canada's appeal of the Panel's finding under Article 10.1, nor to make any finding under this provision.

VIII. Findings and Conclusions

159. For the reasons set out in this Report, the Appellate Body:

Signed in the original at Geneva this 5th day of December 2002 by:

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Luiz Olavo Baptista
Presiding Member

_________________________ _________________________

Giorgio Sacerdoti
Member

Yasuhei Taniguchi
Member