WORLD TRADE ORGANIZATION

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

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

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(i) Terms of reference

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

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

(ii) Composition of Panel

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

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

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

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

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

II. PRELIMINARY RULINGS

1. Canada's request concerning business confidential information

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

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

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

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

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

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

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

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

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

2.12 With regard to outside legal counsel, although the United States understood that a party may include outside legal counsel in its delegation, the United States did not believe that the sanctions in place under the DSU and WTO rules are sufficient to ensure that BCI is adequately protected if access is permitted for outside legal counsel. Moreover, there is too great a potential for a conflict of interest. The situation in *Thailand - Steel* demonstrates the danger of submitting BCI to outside legal counsel who may also represent a domestic stakeholder. In that case, different representatives of the same law firm represented the government and the private sector association. Despite the fact that the law firm, as a representative or counsel to the government, was bound by the same confidentiality obligations under the DSU as Poland, the private sector association somehow came into possession of Thailand's brief. For *inter alia* these reasons, the United States proposed striking "legal counsel or la14law firm28der thegalfli Tc T* side 86 Tc 0

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

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

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

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

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

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

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

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

[15] [Footnote omitted]

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

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

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

2. The European C -1 Tj nes frouest hasclusing BCIess therhe disrebuttalsr that irdrties

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

2.30 The United States also urged the Panel to reject the EC's assertion that Article 12.1 of the DSU requires that the EC be consulted regarding the provisions of the Working Procedures in this case involving third party rights. Article 12.1 states clearly that panels are to consult the parties to the dispute, not the third parties. The United States noted that, with the exception of business confidential

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

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

2.34 In the view of the Panel, only this strict compliance with the unequivocal text of Article 10.3 secures that the interests and rights of third parties are "fully taken into account during the panel process" (Article 10.1) in a manner enabling the Panel to "make an objective assessment of the matter before it" (Article 11.1). In the Panel's view, the object and purpose of Article 10.3 of the DSU is to allow third parties to participate in an informed and, hence, meaningful, manner in a session of the meeting with the parties specifically set aside for that purpose. Third parties can only do so if they have receivee ohts of third partbnd rigce, atT* -ese7e parties arp7erent cehence, meaninl

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III. FACTUAL ASPECTS

(i) Previous system

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

(ii) Previous panel and Appellate Body judgements

3.2 In its decision of 17 May 1999, the original panel in *Canada - Dairy* concluded that Canada "through Special Milk Classes 5(d) and (e) … has acted inconsistently with its obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture* by providing export subsidies as listed in Article 9.1(a) and Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule; … "[30] In its report of 23 September 1999 the Appellate Body upheld the findings in the original panel report with respect to Articles 3.3, 8 and 9.1(c) of the *Agreement on 3.2ttee Å "*[30]

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

3.6 Pursuant to the *Canadian Dairy Commission Act*[36], the *Dairy Products Marketing Regulations*[37] have been modified to exclude commercial export milk and cream from federal licensing,[38] quota[39] and levy requirements[40] and from the requirement to market this milk through the provincial marketing boards. Furthermore, the milk delegation orders issued to provinces pursuant to *the Agricultural Products Marketing Act*, R.S.C. 1985, c. A-6, have been amended to remove provincial authority regarding commercial export milk or cream.[41] As a consequence of the changes made under

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4.1 **United States** claimed w measures' e
ena xport to obtain milk at prices th wer than dom
tho export subsidies within the mea Article 9 or
Agr re. Accordingly, any exports of da oducts produc
und hemes must be within Canada's export subsidy reducti
con the Panel to recommend to the DSB that Canada bri
into obligations under the Agreement on Agriculture.

4.2 ed that the Panel reject the claims of New Zealand and
finc asures, including federal measures and the provincia
Col katchewan, Manitoba, Ontario, Quebec, Nova Scotia,
Prin fully implement the recommendations and rulings of t
con s WTO obligations.

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4.3 ubmitted that as specified by Article 10.3 of the *Agreem*
Can den of establishing that its dairy management measure
put ply with the DSB's recommendations, have not subsidised
exc nt levels under that *Agreement.* Canada has demonstrably fa
bur

4.4 ded that while Canada recognised the presence of Article 10.3,
rep s and the Appellate Body under Article 21.5 of the DSU uniform
that ure is presumed to comply with WTO obligations and, thus, any
cha e bears the burden of proof.[44] In any case, Canada's submissions provi
than and legal arguments to show that it does not subsidise any quantities exp
in e ubsidy commitment levels.

4.5 nd the **United States** replied that none of the cases Canada cited dealt with
the *ulture* and Article 10.3. In cases involving the allegation that subsidisation in
exc y reduction commitments has occurred, Article 10.3 reverses the normal rule
f. The conclusion applies equally to cases brought under Article 21.5.

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

4.7

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

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

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

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

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

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

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

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

4.29 New Zealand contended that Canada does not address the consequences for the agricultural trading system if its view were to be accepted. Export subsidies are fundamentally a means used by governments to maintain domestic prices at levels higher than world prices. The existence of a price difference is, therefore, an indicator that an export subsidy may exist, even if it is not the only element needed to establish an export subsidy. It is not possible to ignore the comparator domestic market when looking at whether an export subsidy exists under Article 9.1. Canada claims that its creation of separate "markets" with producers acting "commercially" in each means that the price difference somehow disappears. But the implications of such an argument are clear. A government could claim no export subsidy existed bysr7ia0y creating in law a separate "market" for export with lower prices than those in the domestic market.

4.30 The **United States** submitted that cost of production data used to set prices in the domestic system contradict the claim in Canada's first submission that farmers free0y supa0y this milk based on normal commercial factors. According to data from the official cost of production survey, less than 30 per cent of Canadian farmers cover theinsece

4.34 The **United States** submitted that the fundamental obligation of the *Agreement on Agriculture* concerning export subsidies is contained in Article 8, which provides that: "Each Member undertakes not to provide export subsidies other than in conformity with thi.1651 Tdm the

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

4.40 **Canada** responded that the complainants arguments disregard the finding of the Appellate Body on what constitutes a 'payment' under Article 9.1(c). The Appellate Body held that "[i]f goods or services are supplied to an enterprise, or a group of enterprises, at *reduced rates* (that is, at below *market rates*), 'payments' are, in effect, made to the recipient of the portion of the price that is not charged".[48] The corollary of this proposition, Canada continued, is that where the recipient of goods or services pays market-rates or market value[49]

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

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

4.45 The market conditions which presently exist are completely different, Canada contended. Hence the fact that there exists a difference between the export price and the regulated domestic price is, in Canada's view, irrelevant. Producers and processors now have access to two markets: a regulated market and a commercial export market. Market forces, not government, now determine the price at which commercial export milk is purchased and sold. More particularly, the price at which commercial export milk is bought and sold reflects the price at which the seller (a private producer) is ready and willing to sell and a buyer (the private processor) is willing to buy. The prices are determined through mutual agreement, without regulatory control or compulsion of any kind. S5 Tc 2ssor)00.1mer -1cesn nd 0r96i9Iivatremugenetatiofl or commercial export miuy.Rat thly, tyd. determine (by thr coenstativt forcon ot sulady andemy an, is intnetatiural) Tj T* -0.1425 T 3199234 Tw (marksld. productsanue faudere, wior commercial export miuy., Canad, thefo are considered thasincare

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

4.52 The United States contended further that Canada insists that there must be a "direct connection" or there must be evidence that the government has "affirmatively instructed or directed someone to provide a financial contribution" under Article 1.1(a)(1)(iv) and that this standard must be satisfied to fall within Article 1 of the *SCM Agreement* and therefore Article 9.1(c) of the

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

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

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

4.57 Canada submitted that it had removed any possibility of any payments "financed by virtue of governmental action". In particular, the CDC and provincial marketing boards have no authority over the decision to produce, purchase or sell commercial export milk. They do not set the price of commercial export milk nor do they control processor margins or pool revenues, impose quantitative limits, issue trans Caits, issue bution,lontempig ly6itati12.75 1s". Ir have 4 11.25 idntitat ""ct1.25le 94sy financial c

processors. Whether or not Canada's measures prohibit, penalise or impede the diversion of commercial export milk into the domestic market is also irrelevant to the question of the existence of

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

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

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

4.67 The **United States** referred to the Appellate Body which stated in the *United States - FSC* case that the obligations under Article 10.1 come into play when three factors are present: (i) there is a subsidy not identified in Article 9.1 of the

whether that transfer involves a benefit to the recipient[64]), reference is therefore made to the definition of a "subsidy" under the *SCM Agreement*. As such, the definition of "subsidy" under the *SCM Agreement* consists of two discrete elements: (i) a financial contribution by a government ; and (ii) conferral of a benefit thereby. [65] The nature of the government action, Canada continued, is determinative as to whether a "financial contribution" exists under Article 1.1(a)(1). If a government has not acted in a manner enumerated in Article 1.1(a)(1), then a "financial contribution" does not exist and there can be no "subsidy". As stated before, Canada's measures adopted to implement the

uses; third, the lower-priced milk has been provided "by governments or their agencies directly or indirectly through government-mandated schemes" as it is made available to processors for export as a result of the prohibition, imposed and enforced by government, on the selling of non-quota milk into

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

4.77 In answer to a question by the Panel, Canada indicated that the average weighted price for fluid milk during the period August 2000-February 2001 was $0.44 per kilogram. However, Canada considered that this average price is significantly inflated by imports under the programme of pasteurised milk for ships' stores use. Canada noted that imported raw milk is bought at prices reflective of US market conditions for such milk. As concerns the average price of imported whole

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

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

5. Articles 3.3 and 8 of the Agreement on Agriculture

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

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

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

6. Articles 1 and 3 of the SCM Agreement

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

V.

4. Article 10.1 of the Agreement on Agriculture

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

5. Article 3 of the SCM Agreement

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

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

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

B. EUROPEAN COMMUNITIES

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

(i) "financed by virtue of governmental action"

5.15 The

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

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

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

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

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

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

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

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

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

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

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

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

2. Article 10.1 of the Agreement on Agriculture

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

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

5.24 Although not attempting to develop a comprehensive analytical framework of the precise relationship between the notion of export subsidy under Article 1(e) of the *Agreement on Agriculture* and Article 1.1 of the *SCM Agreement,* the EC put forward the following: the term "subsidy" is the same under both agreements, as is the expression "contingent upon export performance". Secondly, several provisions directly bear on the relationship between the concept of export subsidy under Article 1(e) and 10.1 of the *Agreement on Agriculture* and that under the *SCM Agreement.* Thus, Article 21 of the *Agreement on Agriculture* provides that "the provisions of the GATT 1994 and of other multilateral trade agreements shall apply subject to the provisions of this Agreement". Article 3.1 of the *SCM Agreement,* in turn, prohibits export subsidies "except as provided in the Agreement on Agriculture". This suggests a co-extensive application of the notion of subsidy, unless the *Agreement on Agriculture* e) a3

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

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

VI. FINDINGS

A. *AGREEMENT ON AGRICULTURE*

1. Burden of Proof

6.1 New Zealand and the United States argue that pursuant to Article 10.3 of the *Agreement on Agriculture*, Canada must establish that no export subsidy has been granted in respect of exports exceeding Canada's reduction commitments. Canada "recognises the presence of Article 10.3", but

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

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

2. Article 9.1(c)

(a) Introduction

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

(a) Are there "payments"?

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

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

(b) "Payments"

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

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

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

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

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

[94]

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

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

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

> In our view, the provision of milk at discounted prices to processors for export under Special Classes 5(d) and

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

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

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

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

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

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

and that

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

6.20 This language makes clear that the working assumption in agricultural trade is not that of a market free of government intervention. The establishment of a fair and market-oriented agricultural trading system, through progressive reductions in agricultural support and protection, is the long-term objective, and the

We noted above that a benefit must be conferred for a payment in kind to exist in the sense of Article 9.1(a).[109]

still have to pay an administrative permit fee.[115] Therefore, *even if* (i) world prices were to constitute

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

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

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

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

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

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

(c) "Financed by Virtue of Governmental Action"

(i) Arguments by the parties

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

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

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

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

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

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

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

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

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

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

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

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

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

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

6.40 This textual and contextual meaning coincides with the Appellate Body's interpretation of this term in its report on *Canada – Dairy* as referring to action which is "

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

6.44 The Panel makes the following observations in this respect. First, under this Panel's, and the Appellate Body's, interpretation of "by virtue of governmental action" as referring to governmental action which is "indispensable to" the financing of a payment, it is not necessarily required that a government "forces", "directs", or "compels" producers to sell into the commercial export market. What is required is that producers would not sell into the commercial export market *but for* governmental action. This requirement is quite different from the one advanced by Canada. Whether the hether

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

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

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

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

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

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

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

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

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

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

6.52 First, as regards the Class 4(m) option, the evidence on the record shows that Class 4(m) sales are a commercially far less attractive option as compared to quota sales or commercial export sales. Canada has confirmed that the average Class 4(m) price is C$10/hl, i.e. about 20 per cent of the

always available to those producers willing to purchase/lease additional quota who bid *at or above*

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

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

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

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

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

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

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

[154]

6.59 As regards the possibility of seizure by federal inspectors in the two examples provided by the United States, the Panel considers that, even if the examples were to accurately reflect the operation

Quebec

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

6.64 Pursuant to the amended paragraph 2.25 of the MMA Agreement

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

Pursuant to the amended paragraph 2.43 of the MMA Agreement,

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

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

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

Ontario

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

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

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

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

[164] United States' Exhibit 6.

[165] Canada's reply to Question 6.

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

[167] United States' reply to Question 6.

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

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

Other Canadian Milk-Exporting Provinces

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

(a) [177]

(b) milk that meets this definition of maining -5.25 TD /F1 11.exempted from domestic regulation;[178]

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

[174] 0.29 1D Tj/F1 16.7756 7Tf 0 Tc paragraph 109.

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

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

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

(vi) Conclusion

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

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

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

(e) Conclusion regarding Article 9.1(c)

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

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

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

[180] United States' reply to Question 19.

[181] Paragraphs 6.7-6.78.

3. Article 3.3

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

6.81 According to data provided by New Zealand and the United States, and spanning the period August 2000 – February 2001, Canadian exports of cheese amount to 9,613 metric tons,[185] and exports of other milk products range from 25.600[186] to 28.826[187] metric tonnes. Canada's reduction commitment levels for the marketing year 2000/2001 are set at 9,076 and 30.282 metric tons, respectively. The United States contended that these figures do *not* include exports under Canada's IREP.[188] As a result, according to this data, Canadian cheese exports would already be subsidized in excess of Canada's reduction commitment levels specified in its Schedule as of February 2001. According to Canada, however, these figures *do* include exports under Canada's IREP.[189] According to Canada, Canadian exports of other milk products between August 2000 and February 2001, *excluding* IREP exports, amount to 25,538 metric tons,[190] and Canadian cheese exports for the same period, *excluding* 190

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

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

4. Article 10.1

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

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

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

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

> The need for sufficient facts is not the only limit on our ability to complete the legal analysis in any given case. In

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

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

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

5. Article 8

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

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

B. SCM AGREEMENT

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

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

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

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

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

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

6.94 In the current proceedings, the Panel notes that (i) the United States argued the Article 3 claim more extensively than before the original panel; (ii) explicitly referred in its First Submission to Article 4.7;[204]

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

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

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

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

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

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

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

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

6.100 Since the Panel, in case it would make an affirmative finding in respect of Article 3.1 of the *SCM Agreement*, would not be able to make the withdrawal recommendation provided for in the first sentence of Article 4.7 of the *SCM Agreement*, the Panel does not need to consider the first sentence of Article 4.7 to determine whether or not it should exercise judicial economy. Having found that it would not be able make a recommendation to withdraw the subsidy, in accordance with the first sentence of Article 4.7, the Panel considers that, *a fortiori*, it would not be able to specify a *time-period* Agreemen-48specify time-

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

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

VII. CONCLUSIONS AND RECOMMENDATIONS

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

7.2 Since Article 3.8 of the DSU provides that "[i]n cases where there is an infringement of the obligations assumed under a covered agreement [including the *Agreement on Agriculture*

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

VIII. ANNEX

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

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

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

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

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

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

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

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

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

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

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

EC - Bananas (European Communities): European Communities - Regime for the Importation, Sale and Distribution of Bananas, recourse to Article 21.5 of the DSU, /WT/DS27/RW/EEC), panel report circulated 12 April 1999.

EC - Asbestos: European Communities - Measures Affecting the Production of Asbestos and Asbestos Products (WT/DS/135/ABR), adopted 5 April 2001;

Indonesia - Automobiles: Indonesia - Certain Measures Affecting the Automobile Industry, (WTDS54, 55, 59,63/R), adopted 23 July 1998;

Mexico – High Fructose Corn Syrup: Mexico - Anti-dumping Investigation of High-Fructose Corn Syrup from the United States, recourse to Article 21.5 of the DSU (WT/DS132/RW), circulated 22 June 2001;

United States – FSC : United States – Tax Treatment for "Foreign Sales Corporations, (WT/DS108/AB/R), adopted 20 March 2000;

United States – Steel: United States - Hot-Rolled Lead and Carbon Steel: Imposition of Countervailing Duties On Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in the United Kingdom, (WD/DS138/AB/R), adopted 7 June 2000;

United States – Shrimp; United States - Import Prohibition of Certain Shrimp and Shrimp Products, Recourse to Article 21.5 of the DSU (WT/DS58/RW), circulated 15 June 2001;

United States - Wheat Gluten: United States - Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities (WT/DS166/R), adopted 19 January 2001;

United States - 1916 Act: United States - Anti-Dumping Act of 1916, (WT/DS136/AB/R, WT/DS162/AB/R), adopted 26 September 2000;

United States - DRAMs: United States - Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors of One Megabit or Above from Korea, Recourse to Article 21.5 of the DSU (WT/DS99/RW), mutually agreed solution notified 20 October 2000, panel report circulated 7 November 2000;

Thailand - Steel: Thailand - Antidumping Duties on Angles Shapes and Sections of Iron or Non-Alloy Steel and H-Beams from Poland**,** (WT/DS122/R), adopted 5 April 2001.

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