16 March 1992

UNITED STATES - MEASURES AFFECTING ALCOHOLIC AND MALT BEVERAGES

Report of the Panel adopted on 19 June 1992
(DS23/R - 39S/206)

1. INTRODUCTION

1.1 On 7 March and on 16 April 1991, Canada held consultations with the United States under Article XXIII:1 concerning measures relating to imported beer, wine and cider. The consultations did not result in a mutually satisfactory solution of these matters, and Canada requested the establishment of a GATT panel under Article XXIII:2 to examine the matter (DS23/2 of 12 April 1991).

1.2 At its meeting of 29-30 May 1991, the Council agreed to establish a panel and authorized the Council Chairman to designate the Chairman and members of the Panel in consultation with the parties concerned (C/M/250, page 35).

1.3 The terms of reference of the Panel are as follows:

> "To examine, in the light of the relevant GATT provisions, the matter referred to the CONTRACTING PARTIES by Canada in document DS23/2 and to make such findings as will assist the CONTRACTING PARTIES in making the recommendations or in giving the rulings provided for in Article XXIII:2."

The parties subsequently agreed that the above terms of reference should include reference to documents DS23/1, DS23/2 and DS23/3 (DS23/4).

1.4 Pursuant to the authorization by the Council, and after securing the agreement of the parties concerned, the Chairman of the Council notified the following composition of the Panel on 8 July 1991 (DS23/4):

Chairman: Mr. Julio Lacarte-Muro

Members: Ms. Yvonne Choi
Mr. Ernst-Ulrich Petersmann

1.5 The Panel met with the Parties on 1-2 October and 2 December 1991. The delegations of Australia, EEC and New Zealand were heard by the Panel on 2 October 1991. The Panel submitted its report to the Parties to the dispute on 7 February 1992.

2. FACTUAL ASPECTS

2.1 The current regulatory structure in the United States alcoholic beverages market arose from the repeal of the Eighteenth Amendment to the United States Constitution, which had established Prohibition. The Twenty-first Amendment to the United States Constitution, adopted in 1933, repeals the Eighteenth Amendment and furthermore provides that:

> "The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

Shortly thereafter, Congress enacted the Federal Alcohol Administration Act which requires, among other things, that all wholesalers obtain basic federal permits, and prohibits suppliers from having an interest in retail outlets and from engaging in many of the commercial practices that were associated with the "tied house" prior to Prohibition. In addition, the Federal government imposes excise taxes on alcoholic beverages.

2.2 Each state has independent legislative and regulatory authority, and, in response to the Twenty-first Amendment, each of the states has enacted laws governing the basis on which alcoholic beverages can be sold. In addition to regulating the sale and distribution of alcoholic beverages within their border for social welfare purposes, states impose excise taxes on alcoholic beverages. All states adopted a three tier system under which the production, wholesale distribution and retail sale of alcohol are kept separate. Some states provide an exception to certain in-state breweries and wineries.

Products

2.3 The measures before the Panel apply to beer, wine and cider. Beer is defined under the 1991 United States Internal Revenue Code (Subpart D, s 5052, Subtitle E) as "beer, ale, porter, stout and other similar fermented beverages (including saké similar product) of any name or description containing one-half of one per cent or more of alcohol by volume, brewed or produced from malt, wholly or in part, or from any substitute thereof." Beer is classified under tariff item 2203.00.00 in the United States Tariff Schedule XX as "Beer made from malt" and the rate is bound at 1.6 cents a litre.

2.4 Natural wine is defined under Subtitle E of the Internal Revenue Code (section 5381) as "… the product of the juice or must of sound ripe grapes or other sound ripe fruit made with such cellar treatment as may be authorized and containing more than 21 per cent of weight by total solids." Wine is classified under tariff item 2204 with various subitems depending on type, alcohol content and type of container. The rates are bound on all the listed items.

2.5 Cider is considered as wine under the Internal Revenue Code. The tax measures on wine under the Code apply also to "All cider except for cider produced with apples in a place other than a bonded wine cellar and without the use of preservatives" (Section 5042). Cider is described in the United States Tariff Schedule XX (tariff item 2206.00.15) as "cider whether still or sparkling", and the rate is bound at 0.4 cents a litre. Canada has initial negotiating rights with respect to this concession.

2.6 The matters before the Panel concern the following federal and state practices with respect to beer, wine and cider:

Federal Excise Tax

2.7 The Omnibus Budget Reconciliation Act of 1990 ("the Act") increased the excise tax on beer from $9 to $18 per barrel. The Act leaves unchanged the existing lower rate of $7 per barrel, however, for the first 60,000 barrels produced by United States breweries with annual production not exceeding 2 million barrels. This lower rate is not available for imported beers.

2.8 The provisions of the Act also increased excise taxes on wine by $0.90 per wine gallon, but introduced for the first time a credit for wine of small United States producers. The Act provides a credit of up to $0.90 per wine gallon for wine produced at qualified facilities in the United States by United States producers of not more than 250,000 wine gallons per year. The credit is provided on a sliding scale basis, depending on actual levels of production. The maximum credit of 90 cents per wine gallon is allowed on the first 100,000 wine gallons of wine for consumption or sale. The credit is reduced by 1 per cent for each 1,000 wine gallons of wine produced in excess of 150,000 wine gallons of wine during the calendar year. This credit is not available for imported wines. The Act provides that the credit is allowable at the time the tax is payable as if the credit constituted a reduction in the rate of the tax.

2.9 The Act increased the excise tax on wine held in stock for sale by $9 per wine gallon. The Act provides, however, for wine produced by small United States producers that the tax increase shall be reduced by the credit provided for small United States producers as described above. No reduction is available for imported wine.

State Excise Tax Measures

2.10 Several states provide an excise tax differential based on annual production. The states of **New York** and **Rhode Island**, and the Commonwealth of **Puerto Rico**, provide an excise tax exemption or lower rate of tax for a specified quantity of beer brewed by in-state breweries. In the state of **Oregon**, an excise tax exemption is applied for a limited quantity of wine sold by United States producers manufacturing less than 100,000 gallons per year of alcoholic beverages.

2.11 In the states of **Kentucky**, **Minnesota**, **Ohio** and **Wisconsin**, an excise tax credit based on annual production is available for specified quantities of beer sold by brewers whose annual production does not exceed an indicated level. In **Kentucky** and **Ohio**, the credit is available only to in-state breweries.

2.12 In **Alabama**, **Georgia**, **Nebraska** and **New Mexico**, the excise tax rate is based on the origin of the product. These states provide for a lower rate of taxation, or a tax exemption, for wine produced by in-state or domestic wineries. **Iowa** applies an excise tax at the wholesale level; only "native wines" may be sold directly at retail, where no excise tax is applied.

2.13 **Michigan**, **Ohio** and **Rhode Island** determine the excise tax treatment based on the use of local ingredients. A lower tax rate is applied in the state of **Mississippi** to wines in which a certain variety of grape has been used.

2.14 The state of **Pennsylvania** provides a tax credit on the purchase of equipment for the production of beer to domestic breweries not exceeding a specified size.

2.15 Table 1 summarizes the differential excise tax measures applied by various states.

State Distribution Requirements

2.16 Many states regulate the distribution of alcoholic beverages, including beer and wine, to points of sale. Such regulations may limit the right to import beer and wine to alcoholic beverage boards, manufacturers, licensed importers, or to wholesalers. Further restrictions are usually applied with respect to which entities can qualify to receive importer, wholesaler or retailer licenses. In-state manufacturers of beer and wine may, in some states, sell directly to retailers. Table 2 presents the distribution requirements of thirty states.

Use of Common Carrier Requirements

2.17 Several states impose restrictions on the transportation system that can be used for the delivery of beer and wine. In particular, certain states require that alcoholic beverages be shipped into the state by common carriers. A common carrier is defined as one that undertakes to carry the goods of all persons indifferently or of all who choose to employ it.

2.18 The state of **Arizona** requires that out-of-state or foreign-produced alcoholic beverages be shipped to their destination by common carriers. In-state produced alcoholic beverages may be shipped in the in-state wholesaler's own vehicle.

TABLE 1. EXCISE TAX RATES AND CREDITS

STATE	PRODUCT	OUT-OF-STATE/ FOREIGN RATE ($/unit)	IN-STATE RATE ($/unit)	CONDITIONS FOR IN-STATE RATE
		Tax Differential Based on Annual Production		
New York	beer	0.21/gallon	0.0	First 100,000 barrels brewed and sold or used in-state per year per distributor-brewer whose principal executive office is in New York state.
Oregon	wine	0.65/gallon	0.0	First 40,000 gallons of alcoholic beverage sold annually in Oregon by US producer of less than 100,000 gallons/year of alcoholic beverages (wine).
Puerto Rico	beer with 1 1/2% or more alcohol	1.80/wine gallon 1.85/wine gallon if containers > 5 gallon	1.25	Total beer production including affiliated producers less than 31,000,000 wine gallons in previous year. All Puerto Rican producers not exceeding 31,000,000 wine gallons in previous year qualify for lower rate regardless of total production of affiliated producers.
Rhode Island	beer	3.00/barrel	0.0	First 100,000 barrels brewed and distributed in Rhode Island.

TABLE 1. EXCISE TAX RATES AND CREDITS (Cont'd)

STATE	PRODUCT	OUT-OF-STATE/ FOREIGN RATE ($/unit)	IN-STATE RATE ($/unit)	CONDITIONS FOR IN-STATE RATE
		Tax Credit Based on Annual Production		
Kentucky	beer	2.50/barrel	50% credit	On up to 300,000 barrels sold or distributed by in-state brewer per year.
Minnesota	beer with 3.2% alcohol or less beer with more than 3.2% alcohol by weight	2.40/barrel 4.60/barrel	credit up to 4.60/barrel	First 25,000 gallons for all qualifying brewers of less than 100,000 barrels/year, regardless of location.
Ohio	beer bottles/cans 12 oz. > 12 oz.	3.50/barrel 0.00125/oz. liquid 0.0075/6 oz. liquid	credit	On up to 9,300,000 gallons/year sold within state by in-state brewer of less than 31,000,000 gallons/year.
Wisconsin	beer	2.00/barrel	50% credit	First 50,000 barrels of domestic beer from producer of less than 300,000 barrels.

TABLE 1. EXCISE TAX RATES AND CREDITS (Cont'd)

STATE	PRODUCT	OUT-OF-STATE/ FOREIGN RATE ($/unit)	IN-STATE RATE ($/unit)	CONDITIONS FOR IN-STATE RATE
		Tax Rate Based on Origin of Product		
Alabama	wine	0.45/litre	0.05/gallon	First 100,000 gallons annually of in-state "native farm" wine.
Georgia	table wine	0.40/litre	0.11	In-state production.
	dessert wine	0.67/litre	0.27	
Iowa	wine	1.75/gallon	1.75/gallon (wholesale) 0.0 (retail)	Tax applied at wholesale level to all product regardless of origin; "native wine" may be sold directly at retail.
Nebraska	wine with less than 14% alcohol	0.75/gallon	0.05/gallon	Wine produced by in-state "farm" wineries.
	wine with 14% or more alcohol	1.35/gallon		
New Mexico	wine	0.25/litre	0.05/litre	First 80,000 litres wine (until 30/6/92, after $0.10/litre to 30/6/94).
			0.10/litre	> 80,000 litres wine (until 30/6/92, after $0.20/litre to 30/6/94). Tax applicable to winery or wine grower that produces less than 200,000 litres of wine per year and, for period 1/1/91 through 30/6/94, is a small domestic producer for purposes on Internal Revenue Code Section 5041

TABLE 1. EXCISE TAX RATES AND CREDITS (Cont'd)

STATE	PRODUCT	OUT-OF-STATE/ FOREIGN RATE ($/unit)	IN-STATE RATE ($/unit)	CONDITIONS FOR IN-STATE RATE
		Tax Treatment Based on Ingredients		
Michigan	wine with less than 16% alcohol	0.135/litre	0.01/litre	Wine manufactured in Michigan from grapes grown in Michigan if have paid Michigan growers $100/ton.
	wine with 16% or more alcohol	0.20/litre	0.01/litre	
Mississippi	wine	0.35/gallon 0.05/gallon	0.35/gallon 0.05/gallon	Lower rate applies to all wines if 51% or more of finished production volume from fermentation of vitus rotundifolia grapes.
Ohio	wine with 4-14% alcohol	0.24/gallon	0.0	If Ohio winery producing less than 500,000 gallon/year, and uses fruit grown in Ohio, where obtainable, on all wine produced or sold in Ohio in following year. Other fruit may be used upon submission of affidavit of non-obtainability to State Department of Liquor Control.
	wine with over 14 to 21% alcohol	0.60/gallon	0.0	
Rhode Island	wine	0.60/gallon	0.30/gallon	Wines made entirely from fruit grown in Rhode Island.

TABLE 1. EXCISE TAX RATES AND CREDITS (Cont'd)

STATE	PRODUCT	OUT-OF-STATE/ FOREIGN RATE ($/unit)	IN-STATE RATE ($/unit)	CONDITIONS FOR IN-STATE RATE
		Tax Credit for Equipment Purchase		
Pennsylvania	beer	2.48/barrel	tax credit up to 0.67/barrel	Domestic breweries of no more than 300,000 barrels/year, for amounts paid between 1/1/74 and 31/12/93 for plant, machinery or equipment for beer production and sale in Pennsylvania, provided that total expenditures by the taxpayer in single year did not exceed $200,000.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Alaska	Importers may not sell products directly to licensees without obtaining a general wholesale license for each distributing point in the state, appointing an agent and obtaining other applicable licenses as required.	In-state breweries and wineries may sell directly to retail licensees and at retail.
California	Imported beer and wine may only be sold to a licensed importer, who in turn may only sell it to other importers or, beer and wine wholesalers. Holders of an out-of-state beer manufacturers certificate may hold licences for the retail sale of their own beer and wine products. Wholesalers and importers may hold licenses for the retail sale of wine. Out-of-state brewers and wineries may be licensed to act as their own wholesalers, but would have to establish a presence in the state.	Beer manufacturers and wine growers may sell their products to anyone holding a license authorizing the sale of beer and wine, respectively. As well, licensed producers of each product may obtain retail licenses to sell products at off-sale package outlets for off-premise consumption.
Connecticut	Foreign producers must obtain an out-of-state shipper's permit to sell beer to manufacturers and wholesalers in the state. Out-of-state brewers and wineries may be licensed to act as their own wholesalers, but would have to establish a presence in the state.	In-state manufacturers of beer and wine must obtain a manufacturer's permit and may sell their product to wholesalers or retailers. Farm wineries and breweries may also sell at retail.
Florida	Vendors (retailers) may not import alcoholic beverages. Importers may sell only to licensed manufacturers or distributors. Importers are prohibited from holding any interest in retail licenses. Manufacturers of alcoholic beverages must distribute only to licensed distributors and licensed vendors.	Florida manufacturers of alcoholic beverages must distribute only to licensed distributors and licensed vendors (retailers).
Hawaii	Only manufacturers and wholesalers may import liquor. Manufacturers and wholesale dealers are prohibited from holding retail licenses.	Hawaiian manufacturers of liquor may sell at wholesale to retailers, and may sell draught beer or wine produced from Hawaiian-grown fruit at retail.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont'd)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Idaho	Only dealers and wholesalers may import; corporations not authorized to do business in the state may not obtain dealers or wholesalers' licenses. A "dealer" is defined as any person who imports, or produces or manufactures, beer for sale in the state. Out-of-state brewers may be authorized to conduct business in Idaho and may obtain a wholesaler license, however the brewer must appoint an in-state registered agent, maintain as in-state office and establish an in-state presence.	Idaho brewers may obtain wholesaler's licenses for the sale of beer at wholesale. Brewers producing less than 30,000 barrels/year may sell at retail.
Illinois	Non-U.S. brewers may sell to either holders of a foreign importer's or a non-resident dealer's license, who may sell alcoholic liquor to each other and to holders of an importing distributor's license. Importing distributors may in turn	Illinois brewers may sell to distributors or importing distributors, retailers and to non-licensees. [Note: The United States has provided a statement from sell to holders of retailers licenses.the Illinois Liquor Control Commission which indicates that the provision with respect to sales to retailers and non-licensees is given no effect, and such sales are in fact prohibited.]
Indiana	An out-of-state brewer may only sell to the holder of a beer wholesaler's permit. Foreign wine can only be imported by wholesalers and wine bottlers. Retail licensees are prohibited from holding any interest in any type of manufacturer's or wholesaler's permit. Foreign persons producing wine or beer are prohibited from holding in-state wholesale permits or from having any interest in a beer wholesaler. "Persons" are defined as a natural individual, firm, corporation, association or other legal entity.	Indiana brewers are entitled to sell beer directly to the holder of a beer dealer's permit or beer retailer's permit and at retail. Small wineries, which produce less than 100,000 gallons of wine per annum and use Indiana-produced grapes and fruits, may sell to retailers and at retail. In-state producers of beer and wine are prohibited from holding any interest in a wholesaler.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont'd)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Iowa	Only holders of a class "A" permit may import beer into Iowa. Holders of a class "C" permit for the sale of beer at retail may only beer purchased from the holders of class "A" permits. Imported wine must be sold either by the state liquor authority or at wholesale by a class "A" wine permit holder. Foreign persons producing beer and wine are prohibited from holding class "A" permits. "Persons" are defined as including any individual, association, partnership or corporation. Wholesalers are prohibited from having any interest in a retail license.	An in-state brewer holding a class "A" beer permit may sell beer directly to retailers and at retail. An in-state winery may sell at wholesale to retailers under authority of a class "A" wine permit.
Kansas	Foreign manufacturers are prohibited from holding distributors licenses but may establish an in-state distributor. Manufacturers and distributors are prohibited from holding retailer licenses.	Kansas manufacturers of wine and beer over 3.2% alcohol by volume must sell their product to wine and beer distributors. Wine and Beer Distributor Licensees may import and sell their product to retailers. Kansas manufacturers of wine and beer over 3.2% are not prohibited from holding distributors licenses. Manufacturers and distributors are prohibited from holding retailer licenses. Farm wineries and micro brewers may sell at retail.
Kentucky	Beer may be imported only by a distributor, who may in turn sell to a retailer. Retailers are prohibited from holding any other types of licenses, and therefore cannot act as distributors. Foreign brewers are prohibited from acting as distributors. A retailer may purchase beer from a brewer or wholesaler.	A Kentucky brewer may sell to retailers. Microbreweries may sell at retail.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont'd)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Louisiana	Only wholesalers are permitted to import alcoholic beverages or beverages of low alcoholic content (alcoholic beverages containing not more than 6% alcohol by volume). Foreign producers of alcoholic beverages, or beverages of low alcoholic content, are prohibited from acting as wholesalers. In-state retailers are prohibited from acting as wholesalers.	Manufacturers of alcoholic beverages or of beverages of low alcoholic content may sell to retailers.
Maine	Only wholesalers may import wine or malt liquor. A retail licensee is prohibited from holding any interest in a wholesale license and a wholesale licensee is prohibited from holding any interest in a retail license. Foreign producers of beer and wine are prohibited from holding wholesale licenses.	A Maine farm winery (defined as producing less than 50,000 gallons of wine per year) and a small Maine brewery (defined as producing less than 50,000 gallons of malt liquor per year) may sell to retailers and at retail.
Maryland	Retail dealers may only purchase alcoholic beverages from manufacturers and wholesalers licensed in Maryland. In-state wholesalers are prohibited from having any interest in a retail license. An out-of-state brewer may obtain a wholesaler's license if one of its corporate officers has been a Maryland resident for at least 2 years.	Maryland brewers may obtain a wholesaler's license in order to sell to retailers, and pub-breweries or micro-breweries may sell at retail. Maryland wineries may sell to retailers, and certain wineries may sell at retail.
Massachusetts	Only holders of wholesaler's and importer's licenses may import beer and wine. Foreign corporations may not be licensed as either wholesalers or importers. Wholesale/import licensees may hold retail package licenses, however, wholesale licensees may not hold retail on-premise licenses. An out-of-state brewer or winery may not establish its own wholesaler in the state. Foreign nationals may not personally hold licenses for the sale of alcoholic beverages.	An in-state wine or beer manufacturer may sell to retail licensees.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont'd)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Minnesota	Foreign corporations may not obtain a wholesaler's license. Imports must be shipped to a licensed wholesaler. Manufacturers and wholesalers are prohibited from holding any interest in retail licenses; retailers are not permitted to hold any interest in a manufacturer or wholesale license.	An in-state manufacturer may sell products at wholesale to retailers by obtaining a wholesaler's license, and in-state breweries may obtain a licence permitting sales at retail.
Missouri	Retailers may only buy intoxicating beer (over 3.2% alcohol by weight) from wholesalers. A foreign or out-of-state manufacturer may apply for a wholesale license if the managing officer for the licence is a resident of Missouri. Manufacturers and wholesalers are prohibited from holding any interest in a retail license.	Retailers may only buy intoxicating beer (over 3.2% alcohol by weight) from wholesalers. An in-state manufacturer may obtain a wholesale license which will permit the sale of intoxicating beer to retailers.
Montana	Out-of-state beer must be shipped to a wholesaler. Wholesalers may not own retailers, nor may they sell beer to the public. Out-of-state brewers licensed by the United-States which produce less than 60,000 barrels/year may sell directly to retailers from their own in-state storage facilities.	In-state breweries producing less than 60,000 barrels/year may sell directly to retailers through their own in-state storage facilities, and at retail.
New Hampshire	Only the holder of an import warehouse's license may import wine into New Hampshire. The holder of a beverage importer's license may only sell foreign manufactured beverages (beer and wine not less than one-half of 1% alcohol by volume and not more than 6% alcohol by volume) to wholesalers. A foreign brewery may obtain a beverage importers licence only if it establishes a corporation in Hampshire or in another US state and registers to do business in New Hampshire. Foreign corporations may not obtain wholesaler's licenses permitting beer or wine deliveries to retailers. Manufacturers and wholesalers are prohibited from holding any interest in a retail license.	New Hampshire brewers may not obtain a wholesaler's license allowing them to sell to retailers. Wine manufacturers may deliver wine to retailers by obtaining a wholesale license and may also sell at retail.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont'd)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Ohio	Wholesale distributors may import beer and wine. The retailer's license does not include the right to import beer or wine. Wholesalers are prohibited from holding any interest in a retail license. An out-of-state brewer or winery may establish its own wholesaler in the state. Foreign producers may not hold a wholesale license.	In-state breweries and wineries may sell to retailers and at retail.
Oregon	Alcoholic liquor may be imported into Oregon only by a person holding a manufacturer's or wholesaler's license, or by the Liquor Commission. Foreign manufacturers of beer and wine may establish their own in-state wholesalers if they establish an in-state presence. Wholesalers are prohibited from holding retail licenses and retailers are prohibited from holding wholesale licenses.	An in-state brewery may sell beer to retail licensees of the Commission. Small in-state breweries can sell at retail. An in-state winery may sell wines at wholesale to the Commission, to retail licensees, or at retail.
Pennsylvania	Foreign breweries must sell to importing distributors. Out-of-state wineries may only sell their products to liquor importers, who in turn may sell it only to manufacturers or the Pennsylvania Liquor Control Board. Importing distributors are prohibited from holding any interest in a retail license and retail licensees are prohibited from holding any other type of license.	Manufacturers are entitled to produce, sell and deliver malt or brewed beverages. In-state brewery licensees may sell malt or brewed beverages to hotels, restaurants, clubs and public service liquor licensees and at retail. "Public Service Liquor Licensees" are defined as being railroad, pullman or steamship companies. In-state limited wineries, whose maximum production is no more than 200,000 gallons per year and whose wine must be from only Pennsylvania fruits, may sell to retailers.
Rhode Island	Only wholesalers may import alcoholic beverages. Foreign manufacturers of beer and wine are prohibited from holding wholesale licenses. In-state manufacturers and wholesalers are prohibited from holding any interest in a retail licensee.	In-state wineries and breweries may sell their products to retailers. In-state manufacturers and wholesalers are prohibited from having any interest in a retail licensee.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont' d)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Tennessee	Retailers may not purchase beer from foreign producers; only wholesale distributors and Tennessee brewers may purchase from foreign producers. Foreign producers are prohibited from being licensed to act as wholesale distributors. [NOTE: The United States provided a statement from the Tennessee Department of Revenue which indicates that the provision prohibiting non-US citizens from being licensed is not enforced.]	Tennessee retailers may purchase beer from in-state manufacturers.
Texas	Imported wine must be sold to wine bottlers or wholesalers for resale to retailers. Retailers are prohibited from purchasing wine directly from foreign producers. Imported beer (no less that 1/2 per cent alcohol by volume and no more than 4 per cent alcohol by weight) must be sold to resident importers for resale to retailers. Retailers and foreign producers are prohibited from holding importer licenses. Manufacturers and distributors are prohibited from holding any interest in the business or premises of a retailer.	In-state wineries may sell wine directly to retailers. In-state wineries, wholesalers and wine bottlers are prohibited from holding any interest in the premises of a package store permitee. In-state manufacturers of beer producing less than 75,000 gallons per annum may sell direct to retailers. Manufacturers and distributors are prohibited from holding any interest in the business or premises of a retailer.
Utah	Only beer wholesalers may import "light" beer (containing less than 3.2% alcohol by weight) into the state. An out-of-state brewer may establish its own wholesaler in the state to sell "light" beer. Wholesalers may not hold retail licenses and retailers may not hold wholesale licenses. "Heavy Beer" is defined as any product containing more than 4% alcohol by volume obtained by fermentation and is considered to be "Liquor" for the purposes of the Act, and must be sold only to the Department.	In-state breweries may sell "light" beer containing less than 3.2% alcohol by weight to retailers and at retail. Brewers are required to sell all heavy beer (containing more than 4% alcohol by volume) to the Department.

TABLE 2. STATE DISTRIBUTION REQUIREMENTS (Cont'd)

STATE	OUT-OF-STATE/IMPORTED BEER AND WINE	IN-STATE BEER AND WINE
Virginia	Imported beer may be sold only to beer importers, who in turn may sell it only to wholesalers. Foreign beer producers are not permitted to hold wholesale licenses. Manufacturers and wholesalers are prohibited from holding retail licenses.	In-state breweries may sell to retailers.
Washington	A foreign brewer or winery must sell to the holder of an importer's license; this license authorizes sales only to wholesalers and/or for re-export. An importer must be a state resident and maintain an office in the state. An out-of-state brewer or winery must establish a principal office in the state to be eligible for an importers license.	In-state wine and beer manufacturers' licenses include the right to act as wholesalers and to sell to retailers, and to act as retailers.
West Virginia	Foreign wineries must sell to licensed wholesalers or the alcohol beverage control commissioner.	An in-state manufacturer of alcoholic liquors (i.e. wine but not beer) may sell to licensed wholesalers, the alcohol beverage control commissioner, and retailers.
Wisconsin	Foreign brewers must obtain an out-of-state shippers' permit which permits them to sell only to licensed wholesalers. All shipments of fermented malt beverages from outside Wisconsin to a Wisconsin wholesaler must be unloaded at and distributed from the wholesaler's warehouse in Wisconsin. An out-of-state brewer may establish its own wholesaler in the state. Foreign wineries may only ship to manufacturers and wholesalers. Wholesalers are prohibited from holding any interest in licenses which permit retail sales of beer for consumption on or off the premises where sold.	In-state brewers may sell fermented malt beverages to retailers, if the brewer obtains a wholesaler's license, and at retail. In-state wineries may sell at wholesale to retailers.

2.19 In **California**, alcoholic beverages imported into the state are required to be transported by common carriers. There is no such requirement for in-state producers, and beer manufacturers and wholesalers are specifically permitted to sell to licensees from their own trucks.

2.20 **Maine** requires that liquor imported into the state be transported by common carriers but permits in-state producers to transport their own product in their own vehicles.

2.21 The state of **Mississippi** requires that imported alcoholic beverages be transported into the state by common carriers. In-state producers and wholesalers may be licensed to transport their own product in their own vehicles.

2.22 In **South Carolina**, alcoholic liquors must be shipped into the state by common carriers. In-state producers and wholesalers are permitted to transport their own product in their own vehicles.

Licensing Fees

2.23 A number of states charge fees for licenses for the sale of beer and wine. In the states of **Alaska** and **Vermont**, different fees are charged for in-state produced and imported products.

2.24 In **Alaska**, in-state brewers must obtain a brewery license at a cost of $500.00 which entitles them to sell to retail licensees. Out-of-state brewers must obtain a General Wholesale License, which costs $1,000.00 plus additional fees up to $10,000.00 based on volume, or a Wholesale Malt Beverage & Wine License, which costs $200.00 plus additional fees up to $10,000.00 based on volume. A General Wholesale License must be obtained for each wholesale distributing point in the state.

2.25 In-state producers of wine in Alaska may obtain a Winery License, the annual fee for which is $250. Out-of-state producers must obtain either a General Wholesale License or a Wholesale Malt Beverage & Wine License, the fees for which are described above.

2.26 In **Vermont**, an in-state manufacturer's license to sell beer (between 1 to 6 per cent alcohol by volume) to wholesale dealers costs $150 per year. Out-of-state brewers require a "Certificate of Approval", at a cost of $1,500 per year, entitling a manufacturer or distributor of malt beverages not licensed under the provisions of the Vermont statute to sell to wholesale dealers.

Local Option

2.27 In the state of **Mississippi**, the legalizing provisions of the alcoholic beverage laws are not applicable in any county within that state unless and until a local option election is held. Notwithstanding an election reinstating the prohibition laws in a political subdivision, the holder of a native wine retailer's permit is allowed to continue to operate under such permits and to renew such permits.

Price Affirmation

2.28 Certain states maintain provisions which limit the price at which sales can be made to wholesalers. These require that out-of-state alcoholic beverages may not be sold at a price above the lowest price available elsewhere either in the United States or in adjoining states. Prices of in-state products are not thus restricted.

2.29 In **Massachusetts**, the Massachusetts General Laws Annotated, (Chapter 138) establishes the general price affirmation rule, applicable to both beer and wine, as follows: "there shall be filed…for a brand of alcoholic beverages [beverages containing 0.5 per cent or more of alcohol by volume]…an affirmation duly verified by the owner of such brand of alcoholic beverage, or by the wholesaler

designated as an agent…that the bottle and case price of alcoholic beverages to wholesalers…is not higher than the lowest price at which such item of alcoholic beverage will be sold by such brand owner or such wholesaler designated as agent or any related person to any wholesaler anywhere in any other state in the United States or in the District of Columbia, or to any state or state agency which owns and operates retail alcoholic beverage stores." In-state producers can sell directly to retailers.

2.30 The **Rhode Island** price affirmation requirements apply to wine: "no holder of a certificate of compliance for … vinous beverages shall ship, transport or deliver within this state, or sell or offer for sale to a wholesaler any brand of … vinous beverages at a bottle or case price higher than the lowest price at which such item is then being sold or offered for sale or shipped, transported, or delivered… to any wholesaler in any state of the United States or in the District of Columbia or to any state, including an agency or [sic] such state, which owns and operates retail liquor outlets". Certificates of compliance are required in order to transport malt beverages and vinous beverages into the state. The price affirmation requirement applies to sales to any wholesaler and only wholesalers may import alcoholic beverages; in-state wineries may sell their products directly to retailers. (General Laws of Rhode Island 1956, 1987 Re-Enactment)

Listing and De-listing Policies

2.31 Eighteen states in the United States maintain Alcoholic Control Boards or Commissions which import, distribute and sell alcoholic beverages at the retail level. In a number of these "control" states, wine must be "listed" with these state marketing agencies in order to gain access either to the state market or to the state stores. The criteria for accepting a new listing for wines varies substantially among control jurisdictions. The specific listing and delisting policies of the nine states which Canada has challenged as GATT inconsistent are detailed in Table 3.

Beer Alcohol Content Restrictions

2.32 Certain states distinguish between beers with an alcohol content of 3.2 per cent by weight (4 per cent by volume) or lower and those with a higher alcohol content. A number of states restrict the location at which beer with over 3.2 per cent alcohol content may be sold, while not imposing the same restrictions on sales of beer at 3.2 per cent alcohol content or lower. In some states, labelling requirements are imposed on beer containing more than 3.2 per cent alcohol content which differentiate it from the lower alcohol content beer. Table 4 indicates the treatment of beer on the basis of its alcohol content in several states.

TABLE 3. LISTING AND DE-LISTING POLICIES

Alabama

Native farm wineries are authorized to sell directly to consumers, to wholesalers and to the Board. Table wines (14% alcohol or less) may be sold by the Alabama Alcoholic Beverage Control Board, and would have to be listed. Table wines may also be imported and sold by wholesalers, and such wines are not listed by the Board. The Board has the monopoly on the importation, wholesale and retail of dessert (fortified, over 14% alcohol) wine.

The criteria for listing includes:

(a) sales in other states
(b) demand
(c) special order
(d) vendor support

No written policy is available. Written notifications are provided. No rationale is provided for negative decisions. Vendors may request an appeal before the Board.

Idaho

The Idaho Alcoholic Beverage Control Division has the monopoly on importation of table wines which may be sold by private wholesalers or through Control Division stores. The Control Division has the monopoly on the importation and retail sale of dessert wine.

Listing criteria include:

(a) need for additional listings in class
(b) need for additional listings in price range
(c) exceptional sales in border states (control states)

Rationale is provided for negative determinations. No appeal procedure is provided.

Fifty-five per cent of the 49 state stores receive new listings.

Mississippi

Importation and wholesaling of wine is by the Mississippi State Tax Commission only. Native wines may be sold directly to retailers and through the Commission. The listing policy, amended in April 1991, includes the following:

> New listings will be considered on May 1 of each year and at such other times as the Commission deems appropriate. All requests for listings must be submitted in writing at least three months prior to the date chosen for the listing. Requests for the listing of new items must be substantiated by facts and figures regarding prices, specifications, alcohol content and other relevant information requested.

All inventory brought into Mississippi is placed in bailment.

The maximum number of items the Commission will authorize for any one company is pre-determined, based on a formula utilizing the number of codes presently listed by each company on the state's existing price list. The formula is as follows:

Codes Presently Listed	New Items Allowed
0-10	2
11-15	3
16-20	4
21 or more	5

TABLE 3. LISTING AND DE-LISTING POLICIES (Cont'd)

The Nine Month Case Order quota for wine is:

Wine	10L	5L	4L 3L	2L 1.5L	1L 75ML	355ML 375ML	187ML
Imported							
$0.00 to $3.00		90	90	90	90	45	
$3.00 up	45	45	45	45	45	45	45
Domestic							
$0.00 to $3.00	45	45	90	90	90	90	45
$3.00 up	45	45	45	45	45	45	45
Champagne and Sparkling Wines							
$0.00 to $5.00				90	90	90	45
$5.01 up				45	45	45	45

No rationale is given for negative decisions and no appeal process is provided.

New Hampshire

The New Hampshire State Liquor Commission has the monopoly on the importation and wholesale of wine which may be sold at retail by Commission stores and private retailers.

Listing criteria for premium wines in State stores include, but are not limited to: vintage; consumer demand; sales performance in the national markets; and potential profitability. De-listing criteria include annual gross profits of less $6,500; unavailability of the product; delisting request from the vendor or manufacturer; non-payment of the wine listing fees; excessive cost increases passed on to the consumer.

Table wines not listed in any other listing may be sold by a manufacturer through the Commission or its licensees. Placement of available wines is automatic upon submission of a request for listing and payment of the registration fee. Renewals are also automatic with the payment of the annual maintenance fee.

New Hampshire law includes statutory requirements that in-state wine be granted preferred treatment in listing procedures where feasible. The delisting review procedure includes preferred treatment for in-state wine.

North Carolina

The state Alcoholic Beverage Control Commission does not import or sell any wines. Local Alcoholic Beverage Control Boards, which are not agencies of the State Board, may sell fortified wines at retail. Local boards have no authority to import fortified wines but must purchase such wines from private, licensed importers. There are no listing or delisting criteria applicable to the sale of fortified wines by the local boards. "Fortified wine" is defined as any wine made by fermentation from grapes,

fruits, berries, rice or honey, to which nothing has been added other than pure brandy made from the same type of grape, fruit, berry, rice or honey that is contained in the base wine, and which has an alcoholic content of not more than twenty-four per cent (24%) alcohol by volume.

Table wine is imported and sold exclusively by private businesses. There are no listing or delisting criteria applicable to the importation or sale of table wine.

Oregon

The Oregon Liquor Control Commission has the monopoly on the importation and wholesaling of wines of 21 per cent or greater alcohol content. Listing criteria are:

(a) market trend;
(b) category need;
(c) sales in other control states and adjacent states;
(d) sales projections in the Oregon market;
(e) planned promotional efforts;
(f) product packaging and taste;
(g) price at retail;
(h) number of existing listings in category;
(i) product uniqueness.

Pennsylvania

There is a Board monopoly on retail off-sales except for licensed Pennsylvania farm wineries which may sell directly to retailers or through the 750 Liquor Control Board stores. With respect to listing, all of the information in the presentation is analyzed to ascertain which items will best fit the Board's needs with regard to selection, price and quality. Items chosen must expand and fit a growing market segment, be supported by marketing plans and promotional efforts and provide the Board with a reasonable return.

Only two applications for a listing are permitted per listing review meeting.

With respect to retaining a listing, class performance indicators based on case sales are used as a guide; other factors considered include uniqueness of a product, price range, competition within category and special appeal.

Store distribution is determined by the Board based on sales of comparable items in the target market.

Vermont

There is a state monopoly on importation and off-sale for dessert wine. Vermont's 16 state operated liquor stores and 55 agency stores do not carry table wines, but only "fortified" or "dessert" wines containing at least 16 per cent alcohol. As an exemption to that rule, the Department of Liquor Control is mandated to list Vermont wines which are "light" or "table" wines (containing 6 to 12 per cent alcohol).

The criteria for listing are:
(a) size extension depends on performance of current listed size
(b) advertising and support given to product
(c) price within category
(d) packaging

TABLE 3. LISTING AND DE-LISTING POLICIES (Cont'd)

(e) representation in the state
(f) sales trends within the category and in other states
(g) suppliers past performance relative to support and availability of product

No rationale is given for negative responses on listing, and there is no appeal process. The procedures are not published. There are no formal written standards for annual listing/delisting decisions. Private stores are not subject to listing criteria. There are 1,500 private stores.

Virginia

The Virginia Department of Alcoholic Beverages Control lists only vermouth and wine produced in the state by "farm wineries" for sale in its the 240 state store outlets. Out-of-state and imported wines may be sold only through private outlets, which are not subject to listing criteria. There are approximately 6,800 licensed private stores that are authorized to sell wine for off-premises consumption.

TABLE 4. BEER ALCOHOL CONTENT REQUIREMENTS

Alabama

Ale and/or malt or brewed beverages with an alcoholic content in excess of 5 per cent by volume are classified as liquors and all such beverages must be sold to the state liquor board or as authorized by the board. A liquor wholesale licensee may not sell liquor to retail licensees. A beer wholesaler (5 per cent alcohol by volume or less) may sell or distribute to all licensees authorized to sell beer and wine.

Colorado

Beer with an alcohol content of over 3.2 per cent by weight is classified as a "malt liquor", and may only be sold at retail in liquor stores or drugstores. A retail licensee under the Fermented Malt Beverages Act may sell beer (up to 3.2 per cent alcohol by weight). This license is separate and distinct from licenses issued in the Alcoholic Beverages Act for the sale of liquor in retail stores and drugstores. A retail liquor store licensee may sell only malt, vinous and spiritous liquors. The same licensed premise may not hold a licence for the sale of alcoholic beverages (over 3.2 per cent by weight) and a license for the sale of beer (3.2 per cent or less) at the same time.

Florida

Beer or malt beverages containing 3.2 per cent or less alcohol by weight may disclose on the label the accurate information about such alcoholic content.

Kansas

Beer with an alcohol content of over 3.2 per cent by weight is classified as an "alcoholic liquor" and must be sold at separate retail premises than beer under 3.2 per cent. Retail licenses for the sale of "alcoholic liquors" may be issued only for retail premises in incorporated cities, or in unincorporated cities in townships whose population exceeds 11,000. "Kansas strong" marking is required for beer over 3.2 per cent alcohol by weight. Beer of 3.2 per cent alcohol or less by weight must be labelled with a statement that the contents contain no more than 3.2 per cent alcohol by weight.

TABLE 4. BEER ALCOHOL CONTENT REQUIREMENTS (Cont'd)

Minnesota

The regulation indicates that brewery and wholesalers' invoices of sale for malt beverages above 3.2 per cent alcohol must have the signature of the purchasing retail dealer, and the number of the retailer's identification card. [NOTE: The United States provided a letter from the Minnesota Department of Public Safety which states that this regulation is not enforced.] Any product that contains not more than 3.2 per cent alcohol by weight must be labelled as such. There is no alcohol content labelling requirement for beer containing more than 3.2 per cent alcohol by weight.

Missouri

Any holder of a Missouri license to sell intoxicating liquor may sell nonintoxicating beer (not more than 3.2 per cent alcohol by weight). A retail licensee holding a nonintoxicating beer license cannot hold another retail license on that same premise. A wholesaler holding a nonintoxicating beer license may also hold licenses to sell intoxicating beer.

Oklahoma

Beer is sold at retail in three different establishments. Beer over 3.2 per cent alcohol by weight is classified as intoxicating liquor and is sold for off-premises consumption only in packages under a package store license. Beer containing not more than 3.2% alcohol is classified as a nonintoxicating beverage and is sold for off-premises consumption only in packages at licensed retail stores. Both types of beer may be sold by the drink on draught or in bottles or cans for on-premise consumption at licensed establishments.

Oklahoma statutes indicates that no person shall attach to any container any label which in any manner indicates the alcoholic contents of said beverage or which carries any reference to the alcoholic strength of such beverage in excess of 3.2 per cent.

Oregon

Oregon breweries and wholesalers may sell malt beverages containing not more than 4 per cent alcohol by weight, in quantities of not less than 5 gallons to any unlicensed organization, lodge, picnic, party or private gathering.

Utah

Brewers may sell light beer (0.5-3.2 per cent alcohol by weight) to wholesalers or retailers but must sell heavy beer (over 3.2 per cent alcohol by weight) to the Utah authorities for sale in state stores and other state-authorized outlets. They are specifically excluded from selling heavy beer to any person within the state other than the State liquor authority.

3. MAIN ARGUMENTS

Matters Before the Panel

3.1 The United States stated that Canada had asked the Panel to examine the GATT consistency of 27 measures which had not been the subject of consultations with the United States before the Canadian request for a panel in this matter. It was a fundamental tenet of the GATT dispute settlement system

that only those matters on which parties to a dispute had consulted, and on which consultations had not proven successful, were properly subject to examination by a GATT panel. This concept was also implicit in the 1989 Improvements to the GATT Dispute Settlement Rules and Procedures.

3.2 In the United States view, consultations provide the parties an opportunity to reach a satisfactory solution to the dispute before proceeding to a panel. The party complained against might modify its practice or, alternatively, convince the complaining party of the GATT consistency of its measure, in either case avoiding the need for a panel. Furthermore, in those situations where resolution is not possible without recourse to a panel, consultations provide the defending party notice of the measure(s) complained of and the consequent opportunity to prepare adequately for the issue. Such basic due process is a fundamental element of all equitable adjudicatory systems, and is especially important to a federal nation like the United States, where the state authorities have substantial law-making authority, particularly in the area of in-state regulation of the sale of alcoholic beverages. It is thus essential that adequate notice be received of any state measures complained of to permit notification of and consultations with the states involved. The United States requested that the Panel examine only those practices on which consultations under Article XXIII:1 had been held.

3.3 Canada argued that in the bilateral consultations which it had held with the United States under Article XXIII, it had identified all of the types of issues now before the Panel, and had also identified particular examples of such issues in specific states. The types of issues and some examples were clearly identified in the charts and other written materials provided to the United States during the bilateral consultations. Other specific examples were raised orally during the consultations under Article XXIII:1.

3.4 With respect to the specific issues which the United States contended had not been the subject of consultations, Canada stated that the matter of a tax credit in **Wisconsin** was raised and discussed with the United States during both consultations held under Article XXIII:1. The **Nebraska** tax issue was raised orally during the second Article XXIII:1 consultation with the United States and the generic issue was explained both orally and in written material. A chart given to the United States at the consultations on 7 March 1991 indicated distribution problems with respect to **Montana** (beer and wine), **Oregon** (beer), **Kansas** (beer and wine) and **New York** (wine). The subject of local option was raised orally in consultations, and **Mississippi** was cited in written material as a state with discriminatory measures related to market access. Canada stated that the listing/delisting issue was raised in consultations. In the written material provided to the United States, there was a specific reference to the **New Hampshire** regulation in this respect. Furthermore, listing/delisting was in the Agreed Terms of Reference (DS 23/4).

Ruling of the Panel

3.5 The Panel carefully considered the parties' arguments with respect to the matters rightfully before it, and the evidence they provided of the issues included in their bilateral consultations under Article XXIII:1. The Panel subsequently made the following ruling and so informed the parties:

RULING OF THE PANEL ON THE SCOPE OF ITS TERMS OF REFERENCE

1. The Panel noted that both parties agreed that the Panel should examine only those practices on which consultations under Article XXIII:1 were held.

2. At its meeting on 29-30 May 1991, the Council agreed that the terms of reference of the Panel were to examine "the matter referred to the CONTRACTING PARTIES by Canada in document DS23/2" unless the Parties agreed on other terms of reference. The Panel noted that, as set out in the Note by the Chairman of the Council (DS23/4), the parties agreed that the terms of reference of the Panel should include reference to documents DS23/1 to 3. Document DS23/3 considerably narrows the scope of the complaint outlined in DS23/1 and 2.

3. The Panel decided to examine all United States measures specified in document DS23/3 and in the submission, dated 23 July 1991, presented by Canada to the GATT Panel.

4. Document DS23/3, page 2, declares that Canada "reserves the right to raise any new measure which may come into effect during the Panel's deliberations". The Panel considers that its terms of reference do not permit it to examine "any new measure which may come into effect during the Panel's deliberations".

5. The Panel noted that Canada no longer requests the Panel to make a finding on the labelling practices of certain states.

General Arguments

3.6 Canada indicated that its request for a GATT Panel arose from complaints received from the Canadian beer and wine industries that resulted from United States federal excise tax measures introduced in 1991 in section 11201 of the Omnibus Budget Reconciliation Act of 1990, as well as a wide range of state tax measures, distribution barriers, licensing fees, transportation requirements, alcohol content regulations, and listing/delisting policies. These measures operated to create significant discrimination against Canadian beer, wine and cider in the United States market.

3.7 Canada considered the United States measures to be inconsistent with its GATT obligations, particularly Articles III:1, III:2, III:4 and possibly Article XI. Canada also indicated that the effect of these measures was to nullify or impair benefits accruing to Canada under the General Agreement.

3.8 In particular, Canada asked the Panel to find that:

(a) the provisions of the Internal Revenue Code of the United States which provided a lower rate of excise tax on domestic beer of qualifying United States producers than that applied to imported beer were inconsistent with Article III:1 and III:2 of the General Agreement;

(b) the provisions of the Internal Revenue Code of the United States which increased excise taxes on wine at the federal level, but provided a tax credit exclusively for wine of certain United States producers established a lower tax rate for domestic wine than for imported wine and were inconsistent with Article III of the General Agreement;

(c) internal taxes levied in the United States by the states of New York, Rhode Island, Kentucky, Minnesota, Wisconsin, Ohio, Pennsylvania, and the Commonwealth of Puerto Rico operated to create a lower tax on domestic beer than on imported beer and were inconsistent with Articles III:1 and III:2 of the General Agreement;

(d) internal taxes levied in the United States by the states of Oregon, Rhode Island, Alabama, Georgia, Iowa, Nebraska, New Mexico, Michigan, Mississippi, and Ohio operated to create a lower tax on domestic wine than on imported wine and were inconsistent with Articles III:1 and III:2 of the General Agreement;

(e) the requirements imposed in the United States by the states of Alaska, California, Connecticut, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Montana, New Hampshire, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wisconsin that imported beer and wine could be sold only through wholesalers or other middlemen while the local like product could be sold directly to retailers including those dedicated retail outlets owned and operated by domestic breweries and wineries were inconsistent with Articles III:1 and III:4 of the General Agreement;

(f) the requirements imposed in the United States by the states of Arizona, California, Maine, Mississippi, and South Carolina that imported beer and wine be transported into and within a state only by a common carrier while no such requirement was imposed on the like domestic (in-state) product were inconsistent with Articles III:1 and III:4 of the General Agreement;

(g) the application in the United States by the states of Alaska (beer and wine) and Vermont (beer only) of a higher licensing fee for imported product than applied to the like domestic product was inconsistent with Articles III:1 and III:4 of the General Agreement;

(h) the exemption of domestic in-state wine, but not the like imported product, from decisions to prohibit the sale of alcohol in certain regions in the United States by the state of Mississippi, was inconsistent with Articles III:1 and III:4 of the General Agreement;

(i) the fixing of price levels (price affirmation requirements) in the United States by the states of Massachusetts and Rhode Island for imported beer and wine on the basis of the price of those products in other neighbouring states, but exempting the like domestic product from this requirement was inconsistent with Articles III:1 and III:4 of the General Agreement;

(j) the listing and delisting practices maintained in the United States by the states of Alabama, Idaho, Mississippi, New Hampshire, North Carolina, Oregon, Pennsylvania, Vermont and Virginia which provided more favourable treatment to domestic products than the like imported product were inconsistent with Articles III:4, III:1 or XI:1 of the General Agreement;

(k) restrictions on points of sale, distribution and labelling based on the alcohol content of beer above 3.2 per cent alcohol by volume maintained in the United States by the states of Alabama, Colorado, Florida, Kansas, Minnesota, Missouri, Oklahoma, Oregon, and Utah were inconsistent with Articles III:1 and III:4 of the General Agreement;

(l) the above inconsistent measures nullified or impaired benefits Canada reasonably expected would accrue to it;

(m) In the alternative, if the Panel found that the tax measures referred to in paragraphs (a) through (d) above were not inconsistent with the General Agreement, Canada asked that the Panel find that those measures nullified or impaired benefits Canada reasonably expected would accrue to it.

3.9 Canada noted that the United States market for beer, wine and cider was an important one for its products and that the less favourable treatment offered to imported products as compared to United States domestic products had a significant effect on Canada's export performance and prospects. In spite of various barriers to trade, Canadian beer sales into the United States totalled approximately $200,000,000 annually which accounted for 90 per cent of Canadian exports of beer. Canada also noted that the United States market for imported wine had declined by 50 per cent since 1984, but the Canadian industry considered the United States to be an important growth market for its products. However, Canada had received strong expressions of concern from the Canadian beer industry that the competitive position of their products had been placed at a disadvantage. Canada cited the Panel on United States - Taxes on Petroleum and Certain Imported Substances (BISD 34S/136) (the "Superfund Panel") to the effect that, "a change in the competitive relationship … must consequently be regarded ipso facto as a nullification or impairment of benefits accruing under the General Agreement" (paragraph 5.1.9).

3.10 The United States stated that with respect to the Panel's examination of state practices, it was important to bear in mind that each state had independent legislative and regulatory authority. Although categories of practices might be similar across states, each state's legislative and regulatory structure represented a specific response to the unique situation within that state. Thus, despite some general similarities, each state practice had unique aspects and had to be examined individually.

3.11 The United States noted that in addition to regulating the sale and distribution of alcoholic beverages within their border for social welfare purposes, states imposed excise taxes on alcoholic beverages. In order to prevent circumvention of these regulations and taxes, and to ensure the orderly assessment and collection of tax liabilities, states had to assert jurisdiction over those who sold alcoholic beverages within their borders.

3.12 The United States further observed that the United States market accounted for over 90 per cent of Canadian exports of beer, an industry in which Canada was the fourth largest exporter in the world. Canada had not alleged that the federal and state practices about which it complained were targeted specifically against Canadian imports into the United States, so the effects of the allegedly discriminatory practices could be expected to be applicable to imports into the United States market from all countries. However, examination of the recent import performance of Canadian beer into the United States market revealed that whereas Canadian beer shipments to the United States had declined, imports from other countries had increased, not only in quantity, but also in value. Because other imports had not been adversely affected, the United States argued that Canada's import problem must be related to something other than the purported United States market access barriers.

3.13 The United States requested the Panel to determine that the practices which Canada raised were in conformity with United States obligations under the General Agreement.

Federal Excise Tax on Beer

3.14 Canada considered that imported and domestic beer were "like products" within the meaning of Article III:2, first sentence. Canada argued that the application of a lower rate of excise tax on a specified quantity of domestic beer products from small producers, which was not also available to imported products, was contrary to the United States obligations under Article III:2 of the General Agreement and acted to afford protection to domestic products contrary to Article III:1. As such, this measure nullified or impaired benefits accruing to Canada under the General Agreement.

3.15 Canada also maintained that the excise tax applied in the United States at the federal level was an internal tax within the meaning of Article III:2. As an excise tax, this tax was applied on a product-specific basis. In the Superfund Panel, the panel found in paragraph 5.1.1 that the United States excise tax applied to like petroleum products which was higher on imported product than on the like domestic product was inconsistent with United States obligations under Article III:2, first sentence. That panel went on to conclude in paragraph 5.1.12 that this violation constituted a prima facie case of nullification and impairment and that an evaluation of the trade impact of the tax was not relevant for this finding. Canada argued that these conclusions applied equally to the exemptions and reduced tax rates granted to United States domestic product which were not available to like imported products.

3.16 Canada stated that approximately 250 brewers in the United States were eligible for the reduced federal tax rate since their annual production did not exceed two million barrels per year. Canadian exports competed directly with the product of United States brewers or vintners in the United States market, regardless of their size. Canada's two major brewers produced in excess of two million barrels of beer annually, and thus faced discriminatory treatment in the United States market against their direct competitors. The Superfund Panel stated in its paragraph 5.1.9 that "Article III:2, first sentence, obliges contracting parties to establish certain competitive conditions for imported products in relation to domestic

products." It went on to note that while Article III:2, first sentence, could not be interpreted to protect expectations on export volumes, "it protects expectations on the competitive relationship between imported and domestic products." The conclusions of this panel were reaffirmed in the Panel on Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages" (BISD/34S/83) (the "Japan Alcoholic Beverages Panel"). Canada considered that a denial of a reduced tax rate to imported products which was granted to like domestic products constituted a difference or change in the competitive relationship between imported and domestic product contrary to Article III:2.

3.17 The United States indicated that the total number of breweries which could qualify for the lower excise tax rate represented approximately only 1.5 per cent of United States beer production. Moreover, because the lower tax rate was available on only the first 60,000 barrels of production, and because many eligible breweries produced far fewer than 60,000 barrels per year, the estimated total number of barrels subject to the lower excise tax rate represented less than 1 per cent of total United States beer production. In other words, over 99 per cent of United States beer products were subject to exactly the same excise tax as that imposed on Canadian beer imports. It seemed apparent on its face that the domestic law did not discriminate against the imported products or provide protection to domestic production.

3.18 The United States recalled that the Japan Alcoholic Beverages Panel had succinctly summarized the two principal obligations of Article III:2 in its report at paragraph 5.9(c):

> "Since Article III:2 prohibited only discriminatory or protective tax burdens on imported products, what mattered was, in the view of the Panel, whether the application of the different taxation methods actually had a discriminatory or protective effect against imported products." (Emphasis added.)

The United States argued that the lower beer excise tax was neither discriminatory nor protective. Furthermore there was nothing in either the letter or spirit of Article III:2 that obligated GATT contracting parties to treat imported products more favourably than they treated virtually their entire domestic industries, or that prohibited contracting parties from aiding very small segments of their domestic industries, provided that imports were not the target of discrimination, either in intent or effect. The panel in the Japan Alcoholic Beverages case interpreted Article III:2 in this way when ruling on the tax treatment Japan accorded to whiskeys and brandies from the European Community (paragraph 5.9(a)):

> "The Panel further found that, as a result of this differential taxation of "like products", almost all whiskeys/brandies imported from the EEC were subject to the higher rates of tax whereas more than half of whiskeys/brandies produced in Japan benefited from considerably lower rates of tax. The Panel concluded, therefore, that (special and first grade) whiskeys/brandies imported from the EEC were subject to internal Japanese taxes "in excess of those applied … to like domestic products" (i.e. first and second grade whiskeys/brandies) in the sense of Article III:2, first sentence." (Emphasis added.)

3.19 Canada observed that paragraph 5.9(c) of the Japan Alcoholic Beverages Panel report related to the consideration of the different methods of calculating ad valorem taxes on imported and domestic product, but not to the application of a specific tax at different rates to imported and domestic product. Canada further argued that there was no de minimis standard in Article III of the General Agreement. The consequences of the discriminatory United States tax measures were considerable. The federal tax measures alone could result in annual potential tax reductions of approximately $140,000,000. Canada also noted that United States trade publications indicated that these measures aided small United States producers at the expense of imported products. Furthermore, although Canada did not

accept the United States' estimate that the tax exemption applied to only 1 per cent of United States production, Canada noted that this figure equalled total Canadian exports of beer to the United States.

3.20 The United States indicated that it was not arguing de minimis trade effect but rather the meaning of discriminatory and protective in the context of Article III:2.

3.21 The United States further maintained that the lower excise tax rate was allowable as a subsidy under Article III:8(b). Article III:8(b) states:

> "The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article and subsidies effected through governmental purchases of domestic products." (Emphasis added.)

The intent of the lower beer excise tax rate was to subsidize small United States beer producers. The United States maintained that a tax exemption or reduction was a GATT-consistent way in which a subsidy to small producers could be made available as it did not affect the competitive conditions any differently than measures allowed by the plain language of Article III:8(b). It differed from the direct payment of a subsidy after taxes had been collected only in that it avoided the actual transfer of funds.

3.22 Canada disagreed that the lower beer excise tax was allowable as a subsidy under Article III:8 (b). Article III:8(b) existed within the framework of the national treatment provisions of Article III. As an exemption from those provisions, it had to be narrowly construed in order to give effect to the national treatment obligations of Article III. This provision was drawn from the Havana Charter, changed to insert the notion that payments to domestic producers from the proceeds of internal taxes required that these taxes must be applied consistent with the provisions of Article III. The Havana Reports explained the purpose of the change as follows:

> "This sub-paragraph was redrafted in order to make it clear that nothing in Article 18 [III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes." (page 66 at paragraph 69)

Article III:8 (b) thus did not permit the exemption or remission of internal taxes to domestic products. The Article referred to two types of measures: payments made exclusively to domestic producers and to government procurement programs. All other types of subsidy programs were excluded from the operation of Article III:8(b). This was confirmed by the rejection of a proposal by Cuba at the Havana Conference to amend the article to read:

> "The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article 25."{entitled: Subsidies in General}

The application of a lower tax rate to United States beer constituted an exemption or remission of an internal tax, directly contrary to the intent of the Article.

3.23 The United States noted that Canada's quotation of the Havana Reports above was incomplete, giving the false impression that Article III overrode Article XVI, dealing with subsidies. The sentence following the Canadian reference read: "At the same time the Sub-Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article [III] would override the provisions [of Article XVI on subsidies.]" GATT drafting history indicated that the GATT contemplated a broad definition of "subsidy":

> It was agreed at Havana that the terms of Article [XVI] were sufficiently wide to cover a system where methods of direct subsidization to domestic industries were not used but whereby "certain domestic industries were exempted from internal taxes payable on imported goods".* (Emphasis added.)

The United States maintained that the federal and state tax measures at issue were thus justifiable under Article III:8(b).

3.24 Canada argued that only direct payments of monies exclusively to the domestic producer could constitute a subsidy for the purposes of Article III:8(b). These monies could not be derived from measures applied inconsistently with Article III. Interpreted in its ordinary grammatical sense, "proceeds" as used in Article III:8(b) meant the revenue generated by the application of internal taxes and charges. Fiscal programs which operated to exempt or reduce the tax payable did not result in "proceeds". In the case of a subsidy permitted under Article III:8(b), the domestic producer had to pay the taxes due and owing before it received the subsidy payment. The domestic producer was thus faced with the same expenses and limitations on business decisions faced by foreign producers. In contrast, in the case of a tax exemption or reduction, the domestic producer neither had to set aside capital nor arrange financing to meet its tax burden, thus giving domestic products an advantage in the market not available to imports. Canada maintained that the exception to national treatment for subsidies to domestic producers did not permit the exemption of such producers from an internal tax nor allowed for a credit against such taxes. Were this not the case, the effect would be to allow an exemption or credit to destroy a general obligation. This was not supported by the language of the exception or the drafting history. Article III:8(b) first referred to "the payment of subsidies." This did not mean all subsidies, but those involving a payment. Secondly, the specific reference to "payments … derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article…" made clear that an after-tax-collection payment was foreseen, but not an exemption from the tax. This was reinforced by the further reference to "applied consistently with the provisions of this Article." An exemption could not be construed as being consistent with Article III:2. To interpret the Article as the United States suggested would undermine the national treatment provisions of Article III, particularly Article III:2, because inconsistent programs could then be considered permissible subsidies. Canada further argued that if the tax rebates and credits qualified as subsidies under Article XVI, as argued by the United States, the United States had failed to notify them as such as required by Article XVI of the General Agreement.

3.25 The United States indicated that the lower excise tax rate applied to floor stocks of beer was a one-time tax which was no longer in force. Canada indicated that it withdrew its complaint with respect to this measure on the basis that by this time the stocks of beer eligible for the lower tax rate had most likely already been dispersed.

Federal Excise Tax Credit for Wine

3.26 Canada argued that the provision of a credit towards the excise tax for wine of small United States producers which was not similarly available to the like imported product was contrary to the United States obligations under Article III:2 of the General Agreement and afforded protection to domestic production contrary to Article III:1. In addition, Canada considered these measures to nullify or impair benefits accruing to Canada under the General Agreement. This tax credit was applied in a manner equal in terms and effect to the application of the lower rate of excise tax on beer. Like beer, Canada considered that imported and domestic wines and ciders were like products within the meaning of Article III:2, first sentence. The tax credit for domestic wines and cider applied to the prevailing excise tax levied

*Analytical Index at XVI-4, quoting Havana Reports, page 107 at paragraphs 11-12.

on both the imported and domestic product. Canada noted that Article III:2 referred to internal taxes of any kind and that the Japan Alcoholic Beverages Panel considered this language to have wide meaning to include the rules for tax collection (paragraph 5.8).

3.27 Canada further argued that the credit on wine was designed to provide domestic products with a lower rate of tax. It was described in the legislation as allowable at the time the tax was payable as if the credit constituted a reduction in the rate of such tax. As a practical matter, this meant that eligible United States producers simply continued to pay the pre-existing lower rate of tax on up to 150,000 wine gallons. This discriminated against imported products as Canadian exports of wine and cider competed directly in the United States market with like products of United States origin, regardless of the annual volume of production by the respective producers.

3.28 The United States argued that the federal wine excise tax credit was neither discriminatory nor protective. The credit was fully available only to small domestic wineries that produced less than 150,000 gallons of wine per year. The credit was gradually reduced as production increased, and was unavailable to any winery producing more than 250,000 gallons of wine per year. Although a number of United States wineries qualified for this credit, they represented in total less than 4 per cent of United States wine production. In other words, over 96 per cent of United States wine products were denied the excise tax credit that was also denied to imported Canadian products. It was thus apparent that the domestic law did not have a discriminatory or protective effect against the imported products nor provided protection to domestic production. The United States also recalled its arguments in paragraph 3.18 with respect to the applicability of the Japan Alcoholic Beverages case.

3.29 Canada observed that the United States Bureau of Alcohol, Tobacco and Firearms (BATF) had estimated that there were approximately 1400 small wineries in the United States. The aggregate production of these wineries was substantial and the total annual potential tax reductions could reach $125,000,000. There was no time limit on this legislation. Canada noted that its arguments with respect to the standards required under Article III which it had cited with respect to beer (paragraphs 3.22 and 3.24 above) equally applied here.

3.30 The United States maintained that the credit to limited quantities of wine from small wineries was allowable as a subsidy under Article III:8(b). It recalled its arguments in paragraphs 3.21 and 3.23 above with respect to the beer excise tax. The clear intent of the federal excise tax credit was to subsidize small United States wine producers. The subsidy was given "exclusively to domestic producers," and was derived "from the proceeds of internal taxes or charges applied" equally to all wine producers, both domestic and foreign.

3.31 The United States stated that the excise tax credit on wine floor stocks was a one-time credit which was no longer in force. Canada recalled that the United States had not provided any evidence that the floor stocks had been disposed of with respect to wine, and its position remained that these measures were contrary to Article III in this regard.

State Tax Rates Based on Annual Production

3.32 Canada argued that state tax laws which offered a tax exemption or reduction to domestic producers based on annual production criteria resulted in discrimination against the product of foreign brewers and vintners. (See Table 1.) This was the case with respect to the tax exemption for in-state brewed beer in **New York** and in **Rhode Island**. In the Commonwealth of **Puerto Rico**, a lower rate of tax was applied to all beer produced by small breweries, with provisions which made it easier for Puerto Rican brewers to qualify. **Oregon** exempted from the normal tax the first 40,000 gallons of wine sold annually in Oregon from small United States manufacturers of alcoholic beverages. The legislative provisions in each of these states made it clear that in all cases the benefit was a reduction or exemption

of the tax that would otherwise be due, not a payment as such to the domestic producer. Canada indicated that the same arguments it made with respect to the reduced federal excise tax for beer were fully applicable with respect to these state measures.

3.33 The United States argued that the intent of the state tax exemptions or reductions in **New York**, **Rhode Island**, **Puerto Rico** and **Oregon** was to provide a subsidy to small producers, consistent with Article III:8(b) of the General Agreement.

State Tax Credit Based on Annual Production

3.34 Canada observed that the states of **Kentucky** and **Ohio** provided tax credits for in-state breweries whose production did not exceed a specified level. **Minnesota** and **Wisconsin** provided similar tax credits to small United States breweries, whether or not located in the state. Canada argued that, as in the case of the federal excise tax credit for wine, the provision of a credit to domestic or in-state beer which was not similarly available to the like imported product was contrary to the United States obligations under Article III:2, and afforded protection to the domestic industry contrary to Article III:1. All of Canada's arguments with respect to the federal wine credit were equally applicable to these state measures. State tax return documents showed that the credits were treated as deductions from tax payable.

3.35 The United States claimed that the measures in **Kentucky**, **Ohio** and **Wisconsin** were subsidies to small producers as permitted under Article III:8(b). The United States provided a statement from the Minnesota Department of Revenue, the state agency with jurisdiction over the tax measure, which indicated that the tax credit in **Minnesota** applied to all qualifying brewers, including Canadian brewers, who met the maximum annual production limitations. This statute had no discriminatory intent or impact.

3.36 Canada indicated that, with respect to **Minnesota**, to the extent that the tax credit applied to all qualifying brewers, it relied on its arguments in paragraph 3.16.

State Tax Rate Based on Origin of Product

3.37 Canada indicated that in some states there was either a lower tax for domestic wine than for foreign wine, or there was an "import" tax applied exclusively to foreign and out-of-state wine (see Table 1). **Alabama**, **Georgia**, **Iowa**, **Nebraska**, and **New Mexico** imposed higher or additional taxes on wine on the basis of out-of-state (or non-United States) origin. Canada considered that the same arguments it had made with respect to the federal excise tax on beer applied to these state taxes. Article III:2 prohibited the imposition of internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. The lower tax rates applied to domestic wines in these states as compared to imported wines were in contravention of this obligation. Canada further indicated that it had withdrawn its complaint with respect to **South Carolina** and **Virginia** on the basis of information provided by the United States.

3.38 The United States provided information indicating that **Iowa** had imposed the same tax rate on all wine, regardless of origin, since 1986.

3.39 Canada noted that the information on **Iowa** provided by the United States indicated that all wholesalers were subject to the $1.75 wine gallonage tax, and that the tax was applied to wine sold at wholesale. However, Canada complained that imported wine was required to be sold through wholesalers and was therefore always subject to this tax, whereas in-state native wine was permitted to be sold at retail and therefore was not necessarily subject to the tax.

3.40 The United States maintained that the tax provisions of **Alabama**, **Georgia**, **Nebraska** and **New Mexico** were subsidies for the benefit of small vintners in terms of Article III:8(b), and recalled its arguments with respect to such subsidies in paragraphs 3.21 and 3.23 above.

3.41 Canada indicated that its arguments with respect to subsidies under Article III:8(b) in paragraphs 3.22 and 3.24 above were equally applicable in the case of **Alabama**, **Georgia**, **Nebraska** and **New Mexico**.

State Tax Treatment Based on Ingredients

3.42 Canada drew the Panel's attention to the practice in the states of **Michigan**, **Mississippi**, **Ohio** and **Rhode Island** of granting a tax exemption or credit to wines produced within the state using local ingredients (see Table 1) that was not available to like imported product. Imported still wines from Canada, including cider, and United States still wines, including cider, as well as imported sparkling wines from Canada and United States sparkling wines, were like products within the meaning of the first sentence of Article III:2. Canada further argued that imported still wines and cider and United States still wines made from fruits other than grapes were like products, if not within the meaning of Article III:2, first sentence, then at the very least, within the meaning of the second sentence in that they were directly competitive or substitutable products.

3.43 Canada argued that these measures were in contravention of Article III:2 which prohibited the direct or indirect imposition of internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Similarly, Article III:2, second sentence stipulated that internal taxes should not be applied to imported or domestic products in a manner contrary to the principles set forth in paragraph 1 of Article III. Canada maintained furthermore that the application of a lower rate of internal tax to locally produced wines in these states than to imported directly competitive or substitutable products afforded protection to domestic production contrary to Article III:1. Canada indicated that following clarification from the United States, it had withdrawn its complaint with respect to Arkansas.

3.44 The United States stated that with respect to **Mississippi**, the tax provision was applicable to all qualifying wine, that is, wine produced from the specified variety of grapes, regardless of the point of origin. The particular variety of grape was not limited to the state of Mississippi but grew also in the Mediterranean area of Europe. Consequently, this provision did not discriminate against out-of-state wine. The measures applied by **Michigan**, **Ohio** and **Rhode Island**, the United States argued, were designed to benefit small vintners and were subsidies consistent with Article III:8(b).

3.45 Canada indicated that its arguments with respect to Article III:8(b) in paragraphs 3.22 and 3.24 above were fully applicable with respect to these state measures. Canada submitted that, with respect to **Mississippi**, the criterion for the local tax rate was tailored to suit wine produced from local grapes which did not grow well outside the southeastern United States.

State Tax Credits for Equipment Purchase

3.46 Canada argued that the granting of a tax credit on the internal tax applicable within the state of **Pennsylvania** to beer for the purchase of plant, machinery or equipment for use in the manufacture of beer was contrary to the United States obligations under Article III:2. In addition, this measure was contrary to Article III:1 in that it afforded protection to domestic production. Canada considered that, from the perspective of the application of an internal tax to domestic beer, the product of the brewery qualifying for this tax credit enjoyed a reduced rate of internal tax. The imported product was assessed the full rate of internal tax since it could not benefit from the tax credit which only applied to beer manufactured within the state. For the small in-state brewer in Pennsylvania who qualified

for the full $200,000 credit, this resulted in an internal tax rate of no more than $1.81 per barrel as compared to the $2.48 per barrel assessed against imported products. This resulted in a violation of Article III:2 in that imported products were assessed a level of tax in excess of those applied to the like domestic product. The credit was not permissible under Article III:8(b) since both the statutory language and the state tax return documents indicated that it was treated as a deduction from tax payable.

3.47 The United States responded that this provision, which benefited small brewers, was a subsidy permissible under Article III:8(b). It recalled its arguments in paragraphs 3.21 and 3.23 above on this matter.

Nullification and Impairment

3.48 With respect to the federal and state tax measures, Canada argued, in the alternative, that if the Panel were to consider the United States measures to be in accordance with the provisions of the General Agreement, then the Panel should find that these United States measures had caused actual nullification of tariff concessions granted by the United States pursuant to Article II of the General Agreement. Canada noted that the three conditions for the establishment of a "non-violation" case under Article XXIII:1(b) as set out in previous panels, e.g., Australian Subsidy on Ammonium Sulphate, BISD II, (1952, pp. 188-195), Treatment by Germany of Imports of Sardines, BISD 1S/58-59) had been met. These conditions were:

(a) the negotiation of a tariff concession;

(b) the subsequent introduction of a governmental measure which upset the competitive relationship between the bound product with regard to like or directly competitive imported products; and

(c) the government measure could not have been reasonably anticipated at the time of the negotiation of the tariff concession.

The United States first bound its tariff on beer, wine, and cider in 1947 and subsequently lower rates were bound for beer in 1967 and for wine in 1951 and 1956. Canada had initial negotiating rights on cider.

3.49 Canada maintained that these tax measures had upset the competitive relationship between United States and imported beer, wine and cider both generally and with respect to specific harm to particular Canadian products. Canada recalled that the Panel on European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal Feed Proteins (the "Oilseeds Panel") (L/6627) had stated that in the context of Article XXIII:1(b):

> "… the CONTRACTING PARTIES have consistently interpreted the basic provisions of the General Agreement on restrictive trade measures as provisions establishing conditions of competition … In the past Article XXIII:1(b) cases, the CONTRACTING PARTIES have adopted the same approach: their findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions. In none of these cases did they consider the trade impact of the change in competitive conditions to be determining. In one case they specifically rejected the relevance of statistics on trade flows for a finding on nullification and impairment … in the framework of GATT, contracting parties seek tariff concessions in the hope of expanding their exports but the commitments they exchange in such negotiations are commitments on conditions of competition for trade, not on volumes of trade" (paragraph 150).

3.50 Canada argued that the measures in question could not have been reasonably anticipated at the time the tariff concessions were negotiated. The federal tax measures of which Canada complained were made effective in 1991. With respect to beer, a tax reduction for small brewers was introduced in 1976, lowering the rate from 9 dollars to 7 dollars. The Oilseeds Panel had rejected the EC contention that it was not legitimate to expect the absence of production subsidies even after the grant of a tariff concession because Articles III:8(b) and XVI:1 explicitly recognized the right of contracting parties to grant production subsidies. The Panel found at paragraph 148:

> "… that the main value of a tariff concession is that it provides an assurance of better market access through improved price competition. Contracting parties negotiate tariff concessions primarily to obtain that advantage. They must therefore be assumed to base their tariff negotiations on the expectation that the price effect of the tariff concessions will not be systematically offset. If no right of redress were given to them in such a case they would be reluctant to make tariff concessions and the General Agreement would no longer be useful as a legal framework for incorporating the results of trade negotiations. The Panel does not share the view of the Community that the recognition of the legitimacy of such expectations would amount to a re-writing of the rule of the General Agreement … The recognition of the legitimacy of an expectation relating to the use of the production subsidies therefore in no way prevents a contracting party from using production subsidies consistently with the General Agreement; it merely delineates the scope of the protection of a negotiated balance of concessions …"

On the basis of the foregoing, Canada maintained that benefits accruing to it had been nullified or impaired by the United States tax measures.

3.51 The United States argued that Canada had not properly made a claim of non-violation nullification or impairment (i.e., a claim under Article XXIII:1(b)). The United States stated that the most logical interpretation of Canadian references to nullification or impairment in its complaint were as a necessary complement to its claims that United States federal and state practices were inconsistent with the General Agreement--that is, nullification or impairment as a necessary element under Article XXIII:1(a). The United States also argued that Canada had not satisfied the requirement of the Annex to the 1979 Understanding on Dispute Settlement, paragraph 5, that it provide "a detailed justification" of the alleged non-violation nullification or impairment.

3.52 Furthermore, the United States indicated that the United States tariffs on beer and wine had been most recently bound in 1989, under Annex 1 to the United States-Canada Free Trade Area Agreement (CFTA). Since the CFTA was authorized under Article XXIV of the General Agreement, Canada's expected benefits from the CFTA tariff concessions were identical to Canada's expected benefits from the GATT. The various state tax measures as well as a differential federal excise tax on beer from small breweries had been in existence at the time the CFTA entered into force on 1 January 1989. These measures could not thus be found to have nullified or impaired the benefits Canada expected from the tariff concession under the CFTA. The United States further argued that any other measure affecting beer and wine adopted after 1989, while not necessarily known, would certainly have been foreseeable by Canada in light of the special considerations given to trade in alcoholic beverages in the CFTA negotiations. This was especially true with respect to the wine excise tax credit, as the CFTA allowed a number of derogations from national treatment with respect to wine products.

3.53 Canada rejected the argument that the CFTA tariff was the relevant binding for determining nullification and impairment under the GATT. Canada indicated that in the context of the General Agreement, the United States assertions with respect to reasonable expectations were entirely without merit. The CFTA tariff was not a GATT bound tariff. Canada noted that the CFTA tariff was negotiated prior to 1989. The Agreement was signed in Ottawa, Washington and Palm Springs on December 22 and 23, 1987 and January 2, 1988.

State Distribution Requirements

3.54 Canada claimed that many states maintained beer and wine distribution provisions which treated imported products less favourably. These distribution systems limited in-state retailers' access to imported beer and wine. Many states permitted retailers to purchase beer and wine directly from some in-state brewers and wineries. However, retailers were required to purchase all imported beer and wine from in-state wholesalers, or, in some states, from manufacturers or the state liquor monopoly. This established an additional distribution level for imported beer and wine and resulted in in-state retailers facing more restricted access to imported beer and wine.

3.55 In addition, Canada indicated that many states maintained measures which prohibited retailers from acting as wholesalers. Retailers could not acquire imported beer and wine directly from the foreign producers. Some states also prohibited non-residents from acquiring wholesalers licenses. In that foreign producers could not act as wholesalers, retailers were further denied the opportunity of purchasing directly from the foreign producer. Canada argued that these distribution systems constituted less favourable treatment of the imported product with respect to purchase, sale and distribution than was afforded to the like domestic product, within the meaning of Article III:4 of the General Agreement. In addition, these measures afforded protection to domestic production contrary to Article III:1, and nullified or impaired benefits to Canada under the General Agreement.

3.56 Canada recalled that in the report of the Panel on Italian Discrimination Against Imported Agricultural Machinery (BISD 7S/60), the panel, in considering the meaning of Article III:4, noted in paragraph 11 that "…the intention of the drafters of the Agreement was clearly to treat the imported product in the same way as the like domestic products once they had been cleared through customs. Otherwise indirect protection could be given." Similarly, in paragraph 12, in interpreting the word "affecting" in Article III:4, the panel was of the view that "… the drafters of the Article intended to cover in paragraph 4 not only the laws and regulations which directly governed the conditions of sale or purchase but also any laws or regulations which might adversely modify the conditions of competition between the domestic and imported products on the internal market."

3.57 Canada further recalled that in the report on United States- Section 337 of the Tariff Act of 1930 (BISD 36S/345) (the "Section 337 Panel") the panel found that the "no less favourable" treatment requirement was unqualified and called for "effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use of products." Canada indicated that it was not opposed to the use of importers/wholesalers per se, but rather to the discriminatory difference in treatment between imported and domestic products, and requested the Panel to find that state measures resulting in such discrimination were contrary to the United States obligations under Article III:4.

3.58 The United States maintained that requiring that out-of-state and foreign product be handled by an in-state wholesaler was not discriminatory. Alcoholic beverages were heavily taxed. Wholesalers served as the primary point for the payment of these taxes. Without rigorous controls, there would be powerful incentives to avoid taxation. Direct shipments to retailers from out-of-state sources could escape state taxes. This potential evasion was curbed, however, by requiring that all retail sales be made through wholesalers, that in-state warehouses be maintained, and that all beer be "at rest" in such warehouses before being sold to retailers. Laws such as these, adopted in every state, assured a paper trail and the physical presence of the beer in-state, facilitating both the audits and inspections essential for effective enforcement.

3.59 The United States further argued that the three tier production and distribution system was important for public policy reasons. The United States Supreme Court had stated that these laws "are components of an extensive system of statewide regulation that furthers legitimate interests in promoting temperance and controlling the distribution of liquor, in addition to raising revenue."

3.60 The United States observed that despite these extensive regulatory controls, the market at all levels of beer distribution was intensely competitive: profit rates were below average; selling prices reflected the cost of goods; and vigorous interbrand rivalry existed for both price and service. Furthermore, they insisted that in-state brewers had no advantage over out-of-state or foreign brewers. The burdens borne by in-state and out-of-state or foreign producers were identical. All ultimately had the same costs of record keeping, audit, inspection, and tax collection, whether directly or through wholesalers. Although some states provided an exception to the three-tier system for in-state breweries and wineries, this merely shifted the burden of compliance from the wholesaler to the producer. It was possible to do this because in-state producers were within the jurisdiction of the state authorities, whereas out-of-state producers were not.

3.61 The United States stated that virtually all United States producers voluntarily chose to use wholesalers to distribute their products, even in those cases in which they could market their products directly to retailers. They made this choice because wholesalers presented a more economically efficient method of distribution. Wholesalers were located in-state, had more intimate knowledge of local market conditions and could ensure distribution to more retail outlets. That Canadian beer and wine had to be distributed through the wholesale level in the United States ensured that it received the preferred form of distribution; the form of distribution most favoured and utilized by nearly the entire United States industry.

3.62 Canada argued that the right to choose the distribution systems was denied to Canadian producers. Looking at it from the perspective of the retailer, the Panel on Canada - Administration of the Foreign Investment Review Act (BISD 30/S/140) (the "FIRA Panel") found that a requirement to buy from domestic suppliers rather than from the producer was inconsistent with Article III:4:

> "The Panel recognized that these requirements might in a number of cases have little or no effect on the choice between imported or domestic products. However, the possibility of purchasing imported products directly from the foreign producer would be excluded and as the conditions of purchasing imported products through a Canadian agent or importer would normally be less advantageous, the imported product would therefore have more difficulty in competing with Canadian products (which are not subject to similar requirements affecting their sale) and be treated less favourably." (paragraph 5.10)

Canada argued that the legislative provisions in the various states fell squarely within the interpretation of Article III:4 of the General Agreement as interpreted by the FIRA Panel. The fact that not all fifty states maintained such systems indicated that it was possible for states to meet the obligations of the United States in a manner which did not discriminate against imported products.

3.63 The United States observed that generally the only producers to take advantage of the opportunity to sell directly to retailers fell into two categories: (1) brewpubs, which were unique commercial establishments that brewed beer on-premises for direct sale to consumers and could only exist if they were allowed to sell direct; and (2) small microbreweries, which for commercial reasons sold direct because they were too small to be carried by wholesalers. Together, these two groups of producers constituted a minuscule part of the United States beer industry. In the case of in-state microbreweries, alternative arrangements were readily available to assure effective and efficient tax collection. The in-state microbrewers had to comply with licensing, warehousing, record keeping, tax collection, and other responsibilities otherwise imposed on the wholesalers. The only difference was the point in the

distribution system where such responsibilities were imposed and where such costs had to be paid. Furthermore, in contrast to the FIRA situation cited by Canada, the required use of wholesalers in this case was not less favourable treatment, but rather the most favoured method of distribution of wine and beer products. As the Section 337 Panel stated:

> "… [T]he mere fact that imported products are subject … to legal provisions that are different from those applying to products of national origin is in itself not conclusive in establishing inconsistency with Article III:4. In such cases, it has to be assessed whether or not such differences in the legal provisions applicable do or do not accord to imported products less favourable treatment."

That panel went on to note that a previous panel had found the purpose of Article III:4 to be the protection of "expectations on the competitive relationship between imported and domestic products." The United States maintained that the state practices complained of with regard to the distribution of wine and beer did not alter in any substantive way the "competitive relationship between imported and domestic products", and requested that the Panel reject the Canadian assertions to the contrary.

3.64 Canada noted that in addition to wholesale distributors, alternative rigorous controls were available, including tax collection at the retail level, or the requiring of bonds from foreign producers to cover estimated tax liabilities. Canada further argued that costs borne by in-state and out-of-state producers were not identical. In-state wholesalers represented an additional layer of costs beyond the costs of record-keeping, audit, inspection and tax collection, which included the costs of delivery, storage, profit and other attendant costs of the wholesale business. By requiring that Canadian producers use in-state wholesalers, the state imposed this additional layer of costs on Canadian producers which it did not impose on in-state producers. The requirement to use wholesalers also restricted Canadian producers' access to the full range of retailers, reduced leverage in negotiating with wholesalers, and insulated the imported product from the retailer in terms of sale and direct promotions. The mere existence of the option to circumvent the distribution system was a valuable commercial asset for breweries in negotiating with wholesalers. Additionally, the widespread use of Exclusive Territorial Agreements (ETAs) among wholesalers substantially reduced the number of wholesalers operating in a specific geographic area, further limiting the flexibility of brewers to market their product since they were required to grant wholesalers an exclusive franchise. Furthermore, as imported beer was normally a secondary line for a distributor, the effective access of the imported beer to the retail level was significantly reduced. Canada also disagreed with the United States contention that only a small proportion of its producers delivered their own product. Canada noted that ten per cent of all United States produced beer was delivered direct by the producer.

3.65 Canada observed that the United States argument that microbrewers were too small to be carried by wholesalers was direct evidence of the discrimination faced by Canadian product which was required to go through in-state wholesalers. Canadian brewers, which were in the same position, had no option but to sell their product through in-state wholesalers, and pay high middleman costs, which in-state producers could either avoid or minimize. Furthermore, Canada noted that, with few exceptions, states requiring the use of wholesalers did not draw a distinction between in-state brewers and wineries on the basis of size. In most states any in-state brewer, regardless of size, could benefit from the exception.

3.66 In the alternative, the United States maintained that should the Panel conclude that the requirement that out-of-state and foreign beer products had to be distributed through in-state wholesalers whereas the products of small domestic microbreweries need not be was technically in violation of Article III:4, this requirement was justified under Article XX(d). Article XX(d) permitted measures which were necessary to secure compliance with laws or regulations which were not inconsistent with the provisions of the General Agreement. The Section 337 Panel had further explained this provision as follows:

> "It was clear to the Panel that a contracting party cannot justify a measure inconsistent with another GATT provision as "necessary" in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it. By the same token, in cases where a measure consistent with other GATT provisions is not reasonably available to it, a contracting party is bound to use, among the measures reasonably available to it, that which entails the least degree of inconsistency with other GATT provisions. The Panel wished to make it clear that this does not mean that a Contracting Party could be asked to change its substantive patent law or its desired level of enforcement of that law, provided that such law and such level of enforcement are the same for imported and domestically-produced products". (Emphasis added.)

Article XX(d) thus provided that an inconsistent measure was acceptable unless there was "an alternative measure which [the Contracting Party] could reasonably be expected to employ." The United States maintained that there was no reasonable alternative scheme which did not result in an unacceptably high risk of tax evasion and inability to regulate the behaviour of out-of-state producers. The problem of enforcement was particularly acute where the tax was a significant part of the retail price, because there was a particularly strong incentive to avoid the tax. If the tax were imposed at the retail level, enforcement authorities would have the impossible task of auditing thousands of retail establishments instead of the relatively few wholesalers. Alternatively, an attempt to collect the tax from out-of-state producers would result in serious jurisdictional problems and dramatically increase the costs of collection and enforcement. Similarly, a bonding requirement with agreed access to records would not work because state officials would have the burden of flying all over the world to verify the records, and still would not have access to all supplemental records necessary for an effective audit, such as bank records. The wholesaler was thus the only reasonable place for beer excise taxes to be collected for out-of-state and foreign products.

3.67 Canada recalled that the practice of GATT panels had been to interpret Article XX narrowly and to place the burden on the party invoking the exception to justify its use of it. In Canada's view, the United States had failed to demonstrate that any of its state distribution measures met the conditions for the application of Article XX(d). In addition to the requirements of the headnote, the criteria of Article XX(d) were:

> (i) that the "laws or regulations" with which compliance was being secured were "not inconsistent" with the General Agreement, and
>
> (ii) that measures in question were "necessary to secure compliance" with those laws or regulations.

In light of the findings of the Section 337 Panel cited by the United States, the burden was on the United States to demonstrate what law it was which was consistent with the GATT and to show that there were no less trade restrictive measures available. Canada submitted that the federal and state tax laws at issue were inconsistent with the GATT, and it was not sufficient for the United States to state in general terms that tax laws and regulations were being enforced by these measures. The quotation cited by the United States above was immediately followed by the statement: "However, it does mean that, if a contracting party could reasonably secure that level of enforcement in a manner that is not inconsistent with other GATT provisions, it would be required to do so." Canada maintained that there were reasonable alternatives that were GATT-consistent or entailed a lesser degree of inconsistency with the GATT that could ensure the same level of enforcement for imported and domestic beer. That not all fifty states maintained discriminatory distribution systems indicated that such alternative measures existed. Canada noted the United States managed to enforce other of its tax laws domestically at the retail level. Article XX(d) did not allow any level of enforcement -- rather it permitted the same level of enforcement on imported and domestic products.

3.68 Canada further argued that there had to be a clear and immediate connection between the "inconsistent measure" and the required enforcement of the "consistent measure". The use of an inconsistent measure simply because it helped to serve the objectives of the consistent measure was not sufficient justification. In and of themselves, the state restrictions on distribution did not enforce the payment of taxes. To consider any measure that might facilitate tax collection or in some way reduce the burden of enforcement as securing the collection of a tax would open up Article XX(d) to justify virtually any form of GATT inconsistent discrimination.

3.69 With respect to specific state practices, the United States observed that Canada had erroneously asserted that brewers in the states of **Montana**, **New Hampshire** and **Wisconsin** were permitted to sell directly to retailers. In **Montana**, only small brewers (of less than 60,000 barrels per year production) were permitted to sell directly to retailers from a Montana storage facility. The United States provided a statement from the Montana Department of Revenue, the state agency with jurisdiction over the measure, which indicated that it applied also to qualifying Canadian brewers. **New Hampshire** law prohibited a brewer from having any ownership or other interest in a wholesale distributor, and a wholesale license was required to to sell at retail. In **Wisconsin**, neither in-state nor out-of-state producers were permitted to sell directly to retailers.

3.70 Canada noted that the **Montana** provision permitting brewers producing less than 60,000 barrels/year to deliver their product directly to in-state retailers applied only to breweries "licensed as such" in the United States, thus effectively excluding Canadian breweries from the exception. With respect to **New Hampshire**, the provision referred to by the United States did not prohibit manufacturers from obtaining in-state wholesale licenses, rather, it prohibited them from holding any interest in the business of any other licensee holding such licenses. With respect to **Wisconsin**, Canada noted that in-state brewers could obtain wholesale licenses to sell direct to in-state retailers, and in-state wineries could sell direct to in-state retailers, whereas foreign producers were not permitted to obtain wholesale permits and could not sell direct to in-state retailers. Canada indicated that it had withdrawn its complaint with respect to Alabama, Oklahoma and New York subsequent to information provided by the United States.

3.71 The United States indicated that any non-United States brewer establishing storage and distribution facilities in the United States could receive a permit from the United States Bureau of Alcohol, Tobacco and Firearms and would therefore be considered "licensed" by the United States for the purpose of the **Montana** statute.

3.72 Canada observed that **Kentucky** statutes permitted distributors to import and sell beer to retailers, however in-state retailers were prohibited from holding distributor licenses. In-state retailers were permitted to purchase foreign produced beer from importers registered with the Kentucky Department of Revenue; however, there was no provision which permitted in-state retailers to purchase directly from Canadian producers. With respect to **Florida**, Canada maintained that the reference in the Florida statute to "licensed manufacturers" could only refer to those manufacturers licensed within the state of Florida and could not be taken to mean any manufacturer anywhere in the world because the state did not have the right extraterritorially to license individuals to manufacture beer.

3.73 With respect to **Kentucky**, the United States provided a statement from the Kentucky Department of Alcoholic Beverage Control, the state agency with jurisdiction over the alcoholic beverage industry, which indicated that in-state retailers could purchase directly from out-of-state brewers, including Canadian brewers. In addition, the United States maintained that the **Florida** statute provided the same rights to all manufacturers, regardless of location. In **Connecticut**, **Idaho** and **Iowa** an out-of-state brewer, including a Canadian brewer, could establish its own wholesalers within the state. In **California**, **Massachusetts**, **Minnesota**, **Ohio**, **Oregon** and **Washington**, out-of-state brewers or vintners, including Canadian brewers or vintners, could establish their own wholesaler in the state. In **Maryland**, there

was no statutory impediment to a foreign brewer obtaining a wholesale license. The United States also stated that an out-of-state brewer, including a Canadian brewer, could establish its own wholesaler to sell beer above 3.2 per cent by weight in **Missouri**. An out-of-state brewer, including a Canadian brewer, could act as its own wholesaler to sell light beer (less than 3.2 per cent alcohol by volume) in **Utah**. In **Virginia**, an out-of-state brewer, including a Canadian brewer, could establish its own importer/wholesaler to sell beer in Virginia. Consequently, in all of these states, a Canadian brewer, or vintner, could sell their product on the same terms as an in-state brewer or vintner.

3.74 Canada argued that even if Canadian producers could establish their own wholesalers in these states, the fact remained that Canadian products could not be obtained by in-state retailers directly from out-of-state distribution points. In order to obtain such access the Canadian producer had to establish an in-state presence in the states of **California**, **Connecticut**, **Idaho**, **Oregon** and **Utah**. Canadian producers were not eligible to obtain a wholesale license in all states because of residency requirements in **Idaho**, **Iowa**, **Maryland**, **Massachusetts**, **Minnesota**, **Missouri**, **Ohio**, **Virginia** and **Washington**. Even if the in-state wholesaler were wholly owned and operated by the Canadian producer, that wholesaler still represented an additional layer of distribution and costs through which Canadian products had to pass before reaching the in-state retailer.

3.75 With respect to **Alaska**, **Hawaii**, **Indiana**, **Kansas**, **Louisiana**, **Maine**, **Maryland**, **Pennsylvania**, **Rhode Island**, **Tennessee**, **Texas**, and **West Virginia**, the United States argued that Canadian producers had access to the commercially preferable method for distributing their products in each of these states. It recalled its arguments in paragraph 3.61 above with respect to distribution systems.

3.76 Canada argued that it was for individual breweries to determine the "commercially preferred method." Whether or not United States producers chose to employ wholesalers to distribute their product as the "commercially preferred method" was irrelevant. It was not the purpose of the General Agreement to permit any Contracting Party to determine, unilaterally and without consultation, to limit through legislation the options and flexibility of firms in another Contracting Party on the grounds that such discriminatory restrictions were in the best interest of these other parties. Canada indicated that a large number of United States breweries exercised their right of self-delivery, a right which was denied to Canadian product. Some Canadian producers had indicated that depending on the circumstances, they would prefer to have the option to market and deliver their own product in the United States to certain classes of customers.

3.77 The United States provided a statement from the Illinois Liquor Control Commission, the state agency with jurisdiction over the measure, which indicated that the **Illinois** provision permitting in-state brewers to sell directly to retailers was not given effect. In fact, an Illinois brewer was not permitted to sell or deliver beer to retailers and non-licensees and was required to deliver its beer to a distributor or importing distributor.

3.78 Canada argued that if statutory provisions were mandatory in requiring that manufacturers licenses issued to brewers allowed the brewer to sell direct to in-state retailers, the question of whether they were currently being applied was irrelevant. In the case of **Illinois**, no discretion was granted to the executive to limit in-state licensees to whom a brewery could deliver its product. Canada recalled that a number of GATT panels had found, as was most recently stated by the Panel on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes (BISD 37S/200) ("Thailand Cigarette Panel"), that "legislation mandatorily requiring the executive authority to impose internal taxes discriminating against imported products is inconsistent with Article III:2 whether or not an occasion for its actual application has as yet arisen ". The test was not whether the measure was being applied at a particular point in time, but whether the legislation mandatorily required the imposition of discriminatory measures - in which case the legislation was inconsistent with the GATT. The statutory language of Illinois did not merely give the executive authority the possibility of acting inconsistently

with Article III:2 (as in Thailand Cigarettes), rather it contained mandatory requirements that were inconsistent with the GATT. According to the principle enunciated in the Thailand Cigarettes case, this made the mandatory state measure inconsistent with the GATT.

3.79 The United States observed that Article III:2 concerned "internal taxes or other internal charges in excess of those applied to like domestic products," and stated that no contracting party "shall otherwise apply internal taxes or other internal charges" to products contrary to the principles of Article III:1 (emphasis added). Similarly, Article III:4 stated that imported products "shall be accorded treatment no less favourable than like products of national origin" (emphasis added). The Illinois state authorities were not enforcing the measure as a result of a specific judicial or administrative decision. The state had ensured that these measures were not being "applied" within the meaning of Articles III:2 and III:4. The fact that the measures had not been repealed was irrelevant, and did not cause them to be in violation of the General Agreement. The Thailand Cigarettes Panel, in paragraph 84, stated that "legislation merely giving the executive the possibility to act inconsistently with Article III:2 could not, by itself, constitute a violation of that provision." Furthermore, the Thailand Cigarettes Panel was even more explicit with respect to the Thai government's issuance of a regulation that would remove business and municipal taxes from all cigarettes, despite the continuing authority under the Tobacco Act for the Thai executive authorities to continue to levy discriminatory taxes:

> "The Panel noted that, as in the case of the excise tax, the Tobacco Act continued to enable the executive authorities to levy the discriminatory taxes. However, the Panel, recalling its findings on the issue of excise taxes, found that the possibility that the Tobacco Act might be applied contrary to Article III:2 was, by itself, not sufficient to make it inconsistent with the General Agreement."

The United States argued that this reasoning applied even more forcefully in the present case. The relevant executive authorities had explicitly stated that they were not enforcing the challenged measures, and that they would not do so in the future. The possibility of application was not sufficient to result in violation of the GATT.

3.80 Canada replied with respect to the Thailand Cigarettes case that the test was not whether the measure was being applied at a particular point in time but whether the legislation mandatorily required the imposition of discriminatory measures--in which case the legislation was inconsistent with the GATT. In the state laws examined, the statutory language did not merely give the executive authority the possibility of acting inconsistently with Article III:2, as in the Thailand Cigarettes case, rather they contained mandatory requirements which were inconsistent with the GATT.

3.81 The United States further argued that the measures maintained by the states of **Connecticut**, **Florida**, **Maryland**, **Massachusetts**, **Missouri**, **Oregon**, **Texas** and **Utah** qualified as "existing legislation" under the Protocol of Provisional Application (PPA). Accordingly, these measures were not part of the United States obligation to apply Part II of the GATT. To qualify under the PPA, legislation must have been in existence on October 30, 1947, the date the United States signed the PPA. Also, the legislation had to be of a "mandatory character", i.e., it had to "impose[] on the executive authority requirements which could not be modified by executive action." The relevant executive for PPA purposes was the executive charged with executing the law in question, not the ultimate executive of the contracting party.

3.82 Canada argued that the burden was on the United States to demonstrate qualification for PPA cover, and recalled that recent GATT panels had taken a very strict view of the circumstances in which the PPA could be invoked. Canada drew the Panel's attention to the arguments by John Jackson in World Trade and the Law of GATT (1969, at page 116), that the PPA did not apply to United States state law. The PPA only protected "mandatory" legislation. If legislation could be overridden by

"executive action," without recourse to the legislature, it was not "mandatory" for the purposes of the PPA. Under the United States Constitution, federal law and treaties, including executive agreements, overrode state law without any further involvement by the legislative arms of government. The PPA, which incorporated the GATT, was an "executive agreement" proclaimed by the President pursuant to statutory delegation. Furthermore, Canada cited a number of United States judicial decisions in which the courts had balanced federal and state powers and found that certain trade restrictive measures relating to the sale of alcoholic beverages violated the federal commerce clause power notwithstanding the Twenty-first Amendment. The Twenty-first Amendment did not require states to discriminate against imported product. Canada maintained, therefore, that the PPA did not protect prior existing United States state law because it was not "mandatory" law for the purposes of the PPA.

3.83 The United States disagreed that state statutes could not qualify as "prior existing legislation" under the PPA. The PPA excused all prior legislation of a mandatory character, not just federal legislation. Legislation of a subcentral governmental body was not excluded, expressly or implicitly. To reinterpret the PPA in the way that Canada suggested would fundamentally alter the nature of United States obligations under the GATT in a way in which neither the United States nor other contracting parties had intended at the time. Jackson's argument did not apply to the area of alcoholic beverage regulation, where the states had substantial authority derived from the Twenty-first Amendment of the United States Constitution.

3.84 Canada argued that even if state laws were eligible for coverage under the PPA, they must still fulfil all conditions necessary to qualify. It was not sufficient to establish that a specific provisions of a state's law in existence in 1947 provided a mandatory right to manufacturers to sell to retailers, but also that the denial of the same right to foreign manufacturers was mandatory by 1947. Furthermore, the Panel considering the United States Manufacturing Clause (BISD 31S/74) had stated at paragraph 39 that the "existing legislation" provision of the PPA was a "one-way street", that was, "once a CONTRACTING PARTY had reduced the degree of inconsistency of "existing legislation" … there could be no justification for a subsequent move to increase the degree of GATT inconsistency of such legislation …". It was thus necessary to establish also that there had not been amendments since 1947 which increased the discriminatory nature of the measure in question. Canada also argued that the introduction of other provisions, subsequent to 1947, which increased the discriminatory nature of the system as a whole would deprive the specific provisions in question of PPA coverage.

3.85 Canada also recalled that with respect to some state practices the United States had relied on Attorney-General opinions or other administrative decisions as proof that a state measure was not applied or not in effect, even with respect to apparently mandatory measures (paragraph 3.77). It thus appeared that there was a form of executive action available, at least in some states, that undermined legislation which was otherwise mandatory on its face. If an Attorney General's opinion or other "general discretionary powers" could override the provisions for which PPA was claimed, the legislation could not be considered mandatory.

3.86 The United States stated that, in the instances cited, the state authorities had made the determination that the legislation was in conflict with the state or federal constitutions, generally as a result of the state Attorney General's determination or a Supreme Court determination about a similar statute in another state. The state authorities were required to uphold the constitution of their state and the United States Government, and were not permitted to engage in unconstitutional actions. However, this narrow circumstance of non-enforcement did not give rise to a general grant of discretion not to enforce statutes. In fact, the state authorities were required to enforce statutes consistent with the state and United States constitutions.

3.87 With respect to specific state statutes, the United States provided the legislation of various states to demonstrate the pre-1947 existence of the relevant provisions. The provisions of the **Connecticut** law which authorized an in-state brewer to sell to wholesalers had not changed since 1941. Likewise, the **Florida** statute giving in-state brewers the right to sell to wholesalers was in effect in 1941. The statute remained in effect in its 1941 form with minor changes in wording which did not affect the substantive rights that it granted. The **Maryland** laws which directed that in-state brewers and in-state wineries had the right to sell to any other license holder, including retailers, dated from 1939. There was also a two-year residence requirement to obtain a wholesaler's license. The current law permitted in-state brewers or wineries to obtain wholesaler licenses. Consequently both pre-1947 law and the current law provided in-state brewers or wineries with the right to sell at wholesale.

3.88 Canada observed that there had been changes to the **Connecticut** law since 1947 which permitted in-state wineries and breweries to act as their own retailers. This had increased the level of discrimination between imported and in-state products. The wording of the **Florida** provisions had changed since 1947. In addition, later provisions permitted in-state beer and wine manufacturers to obtain licenses for the retail sale of their product. With respect to **Maryland**, not only had there been many amendments in the intervening years, but the scope of activity permitted to in-state brewers had been expanded since 1939, further increasing the discrimination between imported and in-state beer.

3.89 The United States argued that the **Massachusetts** statute directing that holders of manufacturing licenses had the right to sell to in-state licensees, including retailers, was enacted in 1933 and last amended in 1939. The **Missouri** measure, which gave the right to in-state brewers to sell intoxicating liquor (above 5 per cent alcohol by weight) at wholesale had not changed since 1947. The right to sell at wholesale was a mandatory statutory privilege available to resident corporations which met the licensing requirements.

3.90 Canada maintained that the provisions of the **Massachusetts** law as they existed in 1949 were not mandatory in nature as they used the term "may". With respect to **Missouri**, Canada noted that the provision related to the activities for which a wholesale license should apply, but it did not make mandatory the grant of the license in the first place. Hence, the discrimination that was contrary to the GATT was not mandatory.

3.91 The United States argued that whether or not the issuance of a license was mandatory was irrelevant; the consequence of the license issuance was the statutory provision of a mandatory right. Furthermore, the statute provided guidelines for determinations to grant licenses, and denial of a license to an applicant who met the guidelines was subject to reversal in a judicial action.

3.92 The United States further indicated that the **Oregon** measures which authorized in-state brewers and vintners to sell at wholesale were in effect from 1945. Although there had been some changes in wording, there had been no amendment to the provision with respect to beer. For wine, the changes had not affected the mandatory right of an Oregon winery to sell at retail. Since 1935, **Texas** law had required that imported beer be consigned to a Texas middleman (either a manufacturer or wholesaler), and further that a company involved in the sale or distribution of wine or ale be majority owned by Texan citizens. The 1935 law also permitted a brewery or winery to sell to other permit holders, including retailers, and permitted wineries to sell directly to the customer. Substantive requirements of the 1935 statute remained in effect and had not been altered by post-1947 amendments to the statute, except to limit the right of breweries to sell direct only to Texas manufacturers of beer producing less than 75,000 gallons annually. **Utah**'s authorization for in-state brewers to sell light beer to retailers dated from 1943. Although there had been changes in wording, current law provided the same right.

3.93 Canada argued with respect to **Oregon** that the section relating to beer had been amended several times since 1947, and that these amendments had increased the inconsistency with the GATT by permitting brewpubs to sell beer at retail. Amendments to the provisions on wine distribution subsequent to 1945 had also increased the inconsistency of the measure with the GATT, by allowing sales to the consumer by holders of a winery license whereas the 1945 law expressly forbad this. This had increased the discrimination between the sale of wine from in-state and foreign manufacturers, thereby disqualifying the provision for PPA cover. Canada further noted that the current provisions of **Texas** law were not mandatory in nature. Accordingly, even if the provisions in effect in 1947 were mandatory, subsequent amendments had removed this mandatory character. Changes had also increased the discriminatory treatment of imported products, granting in-state wine further advantages in terms of direct access to retailers. With respect to **Utah**, the 1943 statute used the word "may", hence there was no mandatory legislation in 1947. Subsequent amendments had increased the inconsistency with the GATT by requiring that a brewery license allow the sale of light beer to licensed retailers, and breweries to operate retail facilities for on-premise consumption of light beer. These increased the mandatory nature of the provision and its inconsistency with the GATT. Canada maintained that these measures did not qualify for PPA cover.

Use of Common Carrier Requirements

3.94 Canada observed that the states of **Arizona**, **California**, **Maine**, **Mississippi** and **South Carolina** required imported alcoholic beverages to be transported by common carriers authorized to operate within that state. In-state producers could deliver their product in their own vehicles. Article III:4 required that imported product be granted treatment no less favourable than that afforded to the like domestic product with respect to transportation. The common carrier requirement was based on product origin and was a formidable barrier to trade. It prevented imported products from competing on equal terms with like domestic products and could result in additional costs. Therefore, Canada maintained that the common carrier requirement was contrary to the United States obligations under Article III:4 of the General Agreement and served to afford protection to the domestic industry contrary to Article III:1. These measures also nullified or impaired benefits accruing to Canada under the General Agreement.

3.95 The United States argued that the common carrier requirement was imposed to ensure independent record-keeping for shipments of out-of-state alcohol. Common carriers were required to maintain records of shipments. These records could be used by state tax authorities to verify information provided by in-state wholesalers and assist to curb tax avoidance. Article XX(d) permitted measures necessary to secure compliance with state tax laws. These states considered that such an independent source of records was necessary because the state authorities did not have access to out-of-state producers' shipping records. The common carrier requirements were necessary to secure compliance with laws and regulations that were not inconsistent with the General Agreement. In-state producers were within the jurisdiction of the state tax authorities, so the state had access to the in-state producer's records and could verify wholesalers' records.

3.96 Canada observed that the United States did not contest its claim that these measures did not accord with Article III:4 but rather had cited Article XX(d). Canada recalled that panels had found that "Article XX is a limited and conditional exception from obligations under other provisions of the General Agreement, and not a positive rule establishing obligations in itself." (paragraph 5.9 of the Section 337 Panel). Canada's arguments on Article XX(d) cited in paragraph 3.67 above equally applied here. Furthermore, the United States had not established which state tax laws consistent with the GATT required this type of enforcement measure. Since not all fifty states maintained common carrier requirements, it seemed that some states had found less trade restrictive ways of enforcing their laws.

Licensing Fees

3.97 Canada brought to the Panel's attention the licensing fees for the sale of beer and wine in **Alaska**, and for beer in **Vermont**, which were higher for imported product. The state of Alaska required local brewers and wine producers to obtain a license entitling them to sell their product at retail. On the other hand, foreign producers of beer and wine were required to obtain a license for each wholesale distributing point in the state, which meant that the foreign producer had to obtain a license for each shipment which it made into Alaska. The fees for these licenses were assessed on an ad valorem basis, depending on the volume of sales, which could reach a level between twenty and fifty times higher than that assessed to the domestic producer. Canada argued that the charging of a higher fee for a license to sell foreign beer and wine constituted either an internal charge not applied to the like domestic product or a requirement providing less favourable treatment to imported products than to like domestic products with respect to their offering for sale within the state. Such a requirement was contrary to Article III:2 or III:4 and had the effect of affording protection to the domestic production. In addition, such measures nullified or impaired benefits accruing to Canada under the General Agreement.

3.98 The United States indicated that **Alaska** imposed the same fee on all wholesalers and did not distinguish between wholesalers handling in-state and out-of-state products. The wholesaler fee covered the regulatory costs of overseeing the large volume of alcoholic beverages and multiple product lines. Both Alaskan brewers sold their beer through wholesalers; consequently, the wholesaler fee did not discriminate against out-of-state beer. Indeed, because Alaskan brewers also paid a brewer's fee while out-of-state brewers did not, Alaskan brewers faced a higher fee for doing business in Alaska than out-of-state brewers.

3.99 Canada responded that irrespective of whether Alaskan brewers chose to sell through their wholesalers rather than directly to retailers, the measure was discriminatory because in-state producers were not required to sell through wholesalers whereas foreign producers were required to do so. Foreign products could not escape the license fees, whereas domestic product could. Therefore the imported product was treated less favourably than the like domestic product.

Local Option Laws

3.100 Canada argued that local option laws affecting the sale of wine in **Mississippi** discriminated against imported products. The legalizing provisions of Mississippi alcoholic beverage laws were not effective in any county unless and until a local option election was held. However, the holder of a Native Wine Retailers Permit was allowed to continue to operate under such permits and to renew such permits even in cases where the prohibition laws were reinstated through elections. Mississippi wines were like products to imported wines within the meaning of Article III. This afforded imported product with less favourable treatment than the like domestic product contrary to Article III:4. Canada was not opposed to the right of a political subdivision to reinstate prohibition but rather to the provision which permitted this to be done in a manner which discriminated against imported products.

3.101 The United States indicated that although this provision existed, it had not been used.

Price Affirmation

3.102 Canada indicated that the states of **Massachusetts** and **Rhode Island** maintained price affirmation provisions which prohibited out-of-state alcoholic beverages from being sold at prices above the lowest price elsewhere either in the United States or in adjoining states. The rules applied with respect to sales to a wholesaler and, in-state producers were not required to sell to wholesalers, while out-of-state producers were required to do so. The requirement limited the price at which sales could be made to wholesalers and prevented the imported product from being priced in accordance with commercial

considerations. It protected in-state product from price competition, affording protection to domestic production. This resulted in less favourable treatment for imported product with respect to internal sale and offering for sale.

3.103 Canada further argued that when the requirements of the price affirmation laws of one state were taken in combination with those of other states, the result was an even greater restriction on the ability of Canadian exporters to compete on the basis of price. They were effectively prevented by this combination of laws from raising or lowering their prices unless this was done with respect to all states simultaneously. This severely restricted their ability to respond to market conditions through pricing. Canada understood that these measures had been found to be unconstitutional, but that the legislation has not yet been repealed in these states. Canada further indicated that it had withdrawn its complaint with respect to Connecticut subsequent to receiving information that the measure had been repealed as of 1 October 1991.

3.104 The United States provided a statement from the **Massachusetts** Beverage Control Commission, the state agency with jurisdiction over the alcoholic beverage industry, which indicated that it did not enforce this measure and would not enforce the measure in the future. With respect to **Rhode Island**, the United States indicated that this measure was only nominally enforced in that Rhode Island was not spending any resources on the enforcement of the measure.

3.105 Canada noted that the non-application of the measures did not in any way detract from their GATT inconsistency. Canada recalled its arguments in paragraph 3.78 above with respect to non-application. Furthermore, the statement provided by the United States from the Chairman of the Massachusetts Alcoholic Beverages Control Commission to the effect that the provisions would not be enforced appeared to be an example of a Liquor Commission exercising discretion. The law remained mandatory and on the books and as such could be enforced at any time. With respect to the Rhode Island measure, Canada indicated that enforcement was carried out for wine upon specific request by the private sector and presumably could be enforced upon a future request.

3.106 The United States recalled its arguments with respect to measures not in force under paragraph 3.79 above, and indicated that they were equally applicable here.

State Listing and Delisting Policies

3.107 Canada observed that there were 18 "control" states in the United States which maintained Alcoholic Control Boards or Commissions which imported, distributed and sold alcoholic beverages at the retail level. In most of these "control" states, imported wine had to be "listed" with these state marketing agencies or Alcoholic Control Boards in order to gain access either to the state market or to state stores. Canada indicated that it was concerned with the practices of nine of these boards which operated state stores where wine was sold. (Alabama, Idaho, Mississippi, New Hampshire, North Carolina, Oregon, Pennsylvania, Vermont and Virginia.) The alcoholic control board listing policies for accepting a new listing for wines varied substantially among states, but in these states provided preferential treatment of in-state wine.

3.108 Canada stated that **New Hampshire** legislation provided that the Commission should, whenever feasible, purchase and list for sale in all state stores the domestic wines manufactured or bottled in the state. The **Vermont** Department of Liquor Control wholesaled and retailed fortified wines (alcohol content of more than 16 percent) and malt beverages containing more than 6 per cent alcoholic content in the 16 government operated liquor stores. However, these stores listed and sold "light" or table wines (wines containing 6-12 per cent alcohol by volume) only if they were produced in Vermont. Although wine produced in **Pennsylvania** could be sold directly to retailers without reference to listing requirements, the Liquor Control Board had a monopoly on the sale of wine at the retail level which it sold at its 750 stores across the state. Imported products were subject to listing requirements which included sales in surrounding and border states.

3.109 Canada further argued that container size restrictions with respect to wine listings also existed in **Vermont** as well as in **Idaho**, **New Hampshire** and **Pennsylvania**. In addition **Alabama**, **Idaho**, **New Hampshire**, **North Carolina**, **Vermont** and **Virginia** included in their listing criteria sales in other states (often specific neighbouring states). This requirement made it more difficult for new products to break into the market.

3.110 Furthermore, Canada maintained that some states had restrictions which had negative effects on new products. In **Mississippi**, the listing policy favoured products already listed by allowing more new items to be listed based on the number of existing products listed by a manufacturer. Native wines were listed automatically. In **North Carolina**, a listing applicant had to be represented by a North Carolina Broker doing business in North Carolina. The **Vermont** listing criteria also included "representation in the state".

3.111 Lack of transparency was a common problem, and Canada indicated that it had made unsuccessful attempts to obtain a written policy from **Alabama**. In **Alabama**, **Idaho**, **Mississippi**, **North Carolina**, **Vermont** and **Virginia**, no rationale was given for negative decisions on listing applications. In some cases, there was no notification with respect to a negative decision on a listing application. Only the states of Alabama, New Hampshire, North Carolina and Pennsylvania had an appeal process if an application was unsuccessful.

3.112 Canada insisted that the implementation of a listing or delisting policy which provided preferential treatment of in-state produced wines was contrary to the United States obligations under Article III:4 of the General Agreement and afforded protection to domestic production contrary to Article III:1. This action also nullified and impaired benefits accruing to Canada under the General Agreement. Canada indicated that it had withdrawn its complaint with respect to Iowa, Maine, Michigan, Montana, Utah, Washington and West Virginia on the basis of information it received in the course of the Panel's proceedings.

3.113 The United States indicated that the states of **Mississippi** and **Oregon** did not sell wine in state stores. The wholesale and retail sale of wine in these states was performed by the private sector. The United States provided a statement from the North Carolina Alcohol Beverage Control Commission, the state agency with jurisdiction over the alcoholic beverage industry, which indicated that in **North Carolina** "unfortified" wines (no more than 17 per cent alcohol content) could be sold only by the private sector. "Fortified" wines could be sold both by the private sector and by county or municipal (i.e., public) Alcoholic Beverage Control (ABC) boards, which were not subject to listing/delisting requirements. Accordingly, North Carolina did not impose any listing/delisting requirements on the sale of any wine.

3.114 Canada noted that the **Mississippi** State Tax Commission had the monopoly on the importation of wine and, with the exception of native wine, the Commission also had the monopoly on the wholesale of wine. In contrast to imported wine, Mississippi wine could thus be sold directly to retailers, customers or the Commission without reference to listing requirements.

3.115 The United States provided a statement from the Alabama Special Assistant Attorney General with jurisdiction over the alcoholic beverage industry which indicated that **Alabama** did not maintain a preferential listing policy for in-state wine. The **New Hampshire** listing/delisting regulations stated that in-state wine should be listed and sold "whenever feasible". The criteria for determining feasibility were based on commercial considerations and therefore the State Liquor Commission did not apply a preference to in-state wines.

3.116 With respect to **Vermont** and **Virginia**, the United States stated that both had an extensive system of private retail outlets for the sale of wine, where listing/delisting requirements were not applicable, as well as a much smaller number of state stores. Vermont had approximately 1500 private retail outlets where wine was sold, and only about 70 state stores. Virginia had 6800 private retail outlets compared to only 240 state outlets. Consequently, in both states there were equivalent commercial opportunities for imports compared with in-state wine, in accordance with Article III:4.

3.117 Canada argued that the fact that locally produced wines could be sold through private wholesalers and also through the state system, whereas imported wine did not have access to the state stores, constituted preferential treatment. Furthermore, although there might be a large number of retail outlets, imported product had access to these only through wholesalers which did not normally sell to all retail outlets.

3.118 The United States observed that the lack of transparency, sales elsewhere in the United States as a listing criterion, and the need for listing and delisting within the territory complained about by Canada did not provide in-state or United States-produced wine with more favourable treatment than imports. The practices applied to all wine equally, regardless of origin.

3.119 Canada noted that the United States had never notified the activities of the state liquor commissions under the provisions of Article XVII of the General Agreement, even though most of these Alcohol Control Boards or Commissions purchased imported and domestic wines for resale to the general public. Canada recalled that the Panel on Canada - Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies (BISD 35S/37) had examined the listing practices of the Canadian provincial liquor boards which operated as state trading enterprises under Article XVII. That panel ruled that where a monopoly existed with respect to importation and distribution, the distinction between Article III and Article XI had little practical effect. The panel ruled that those practices of the provincial liquor boards with respect to listing and delisting which discriminated against imported product were contrary to Article XI:1 of the General Agreement. In the event the Panel did not consider these measures to fall under Article III:4, Canada asked the Panel to examine them in light of Article XI.

Beer Alcohol Content Restrictions

3.120 Canada observed that the states of **Alabama**, **Colorado**, **Florida**, **Kansas**, **Minnesota**, **Missouri**, **Oklahoma**, **Oregon** and **Utah** provided for differential treatment of beer based on its alcohol content with respect to distribution, points of sale and labelling. Beer with less than 3.2 per cent alcohol by weight was afforded more favourable treatment, although Canada argued that all beers were "like product" irrespective of their alcohol content. Canada also noted that the definition of beer found in the United States Internal Revenue Code distinguished between beer and de-alcoholized beer, the dividing line being 0.5 per cent alcohol by weight, and not between beers of differing alcoholic content. Similarly, there was one tariff line for beer in the Harmonized System and a separate tariff line for de-alcoholized beer. The 3.2 per cent level was entirely arbitrary, although Canada observed that major portion of the market for 3.2 per cent beers in these states was served by United States manufacturers. The restrictions based on beer alcohol content treated imported like product less favourably and afforded protection to the United States industry, contrary to Article III:1.

3.121 The United States argued that state measures which accorded differential treatment to beer containing not mote than 3.2 per cent alcohol by weight were not contrary to United States obligations under Article III:4. Article III:4 did not prohibit differential treatment between "like" products if it was not discriminatory, and did not prohibit different treatment when the products were not "like" products. The state measures at issue were non-discriminatory. United States-origin beer with an alcohol content of 3.2 per cent by weight or less was treated exactly the same as Canadian 3.2 per cent. Similarly, all beers with an alcohol content of more than 3.2 per cent by weight were treated the same.

3.122 The United States further observed that the fact that United States manufacturers provided the significant portion of the 3.2 per cent beer market by itself had no bearing on whether these measures were inconsistent with the General Agreement. Domestic manufacturers in all countries provided the significant portion of the market for particular products, in part because of their closer proximity to and greater familiarity with the domestic market. Certain Canadian-produced beer qualified under the statutes, although some Canadian brewers had apparently chosen not to compete in this market. Labatt's, the second largest Canadian beer manufacturer, produced a beer that satisfied the 3.2 per cent by weight criterion which was sold in Colorado and Utah. Other foreign manufacturers similarly offered 3.2 per cent beer for sale in these markets. The state statutes which prohibited or mandated the inclusion of alcohol content on labels did not in any way discriminate against foreign products. The costs of printing unique beer labels for individual states were no lower for United States producers than they were for producers of imported beer.

3.123 The United States also argued that beer with an alcohol content of 3.2 per cent or less by weight need not be considered a product "like" beer with an alcohol content greater than 3.2 per cent by weight. Beer with an alcohol content of 3.2 per cent or less, including most so-called "light" beer, appealed to a distinct market segment in the United States specifically, those customers who enjoyed the taste of beer but preferred to consume a beverage with a lower alcoholic content, to maintain sobriety or to reduce caloric intake. Manufacturers specifically targeted this market segment in their advertising and marketing. In addition, states encouraged the consumption of 3.2 per cent beer over beer with a higher alcoholic content specifically for the purposes of protecting human life and health and upholding public morals.

3.124 Canada argued that appeal to a distinct market segment was not the determining factor of "like product". The Japan Alcoholic Beverages panel found that beverages with small differences in alcoholic content could still be like products. It further reasoned that:

> "Since consumer habits are variable in time and space and the aim of … ensuring neutrality … as regards competition between imported and domestic like products could not be achieved if differential taxes could be used to crystallize consumer preferences for domestic products …"

Canada noted that measures which favoured 3.2 per cent beer operated to reinforce market segmentation and crystallized the consumer's preference for 3.2 per cent beer, discouraging direct competition between all types and brands of beer.

3.125 The United States argued, alternatively, that if the Panel were to determine that state measures which differentiated between beer with 3.2 per cent alcohol by weight or less and beer with greater than 3.2 per cent alcohol by weight were contrary to United States obligations under the GATT, such measures could be justified under Article XX, paragraphs (a) and (b). States had legitimate interests in protecting human life and health and public morals that necessitated measures to discourage the consumption of beer with an alcohol content greater than 3.2 per cent by weight. In choosing measures that applied equally and in a non-discriminatory manner to both domestic and imported beers, states had chosen measures that, if found to be inconsistent with United States obligations under the GATT, were the least restrictive measures they could reasonably be expected to employ. Such measures satisfied the standards necessary for invoking Article XX.

3.126 Canada argued that the United States had failed to establish that these measures were "necessary" to protect human life and public morals within the meaning of Article XX(a) and (b). These goals were not achieved by measures which merely discouraged the consumption of beer with over 3.2 per cent alcohol by weight. Canada noted that in the Supreme Court of the United States it had been concluded that consumption of sufficient quantities of 3.2 per cent beer could also result in drunkenness. Canada maintained that these measures reinforced the market share which domestic beer already had, thereby affording protection to domestic production contrary Article III:1, and that they were a disguised restriction on trade in the sense of the headnote to Article XX.

3.127 Canada observed that a number of states restricted the locations where beer over 3.2 per cent alcohol by weight could be sold compared to beer at 3.2 per cent. As shown in Table 4, in some instances beer greater than 3.2 per cent alcohol could not be sold by the same licensee or at the same outlet as "light" beer. In **Oklahoma**, for example, beer over 3.2 per cent alcohol by weight was classified as intoxicating liquor and was sold at retail for off-premise consumption only in packages under a "package" store license. Retail dealers who sold "non-intoxicating" beverages could sell these products in their original packages, or on draught, for consumption on or off the premises. Thus the draught beer market was denied to imported beer with higher alcoholic content.

3.128 Canada indicated that the states of **Florida**, **Kansas**, **Oklahoma** and **Minnesota** imposed labelling requirements on beer containing more than 3.2 per cent alcohol content which differentiated it from the lower alcohol content beer. For example, in **Kansas**, beer over 3.2 per cent by weight was required to be labelled as "Kansas strong", whereas no such labelling requirement was imposed on beer of lower alcohol content. In **Oklahoma**, on the other hand, the bottle label could not indicate the alcohol content if its contents was in excess of 3.2 per cent alcohol by weight. Canada provided specific citations with respect to these measures.

3.129 The United States provided a statement from the Florida Department of Business Regulation, the state agency with jurisdiction over the alcoholic beverage industry, which indicated that **Florida** did not prevent the identification of alcohol content on alcoholic beverages containing more than 3.2 per cent alcohol. The United States provided a statement from the Minnesota Department of Public Safety, the state agency with jurisdiction over the alcoholic beverage industry, which indicated that the **Minnesota** labelling regulation with respect to the alcohol content of any beer product had been repealed. Furthermore the Minnesota requirement that brewery and wholesaler's invoices of sale for malt beverages above 3.2 per cent alcohol have the purchasing retail dealer's signature and identification card number was no longer enforced. The United States also observed that, contrary to Canada's assertions, in **Oklahoma**, beer over 3.2 per cent alcohol could be in draft form, as a draft keg was considered a retail container under Oklahoma law. The United States provided a statement from the Oklahoma Alcoholic Beverage Law Enforcement Commission, the state agency with jurisdiction over the alcoholic beverage industry, which indicated that this was the case.

3.130 The United States further argued that certain state measures with respect to beer alcohol content pre-dated the PPA. The **Oklahoma** statute concerning, inter alia, alcohol content label requirements, was enacted in 1947. It was amended in 1985; however, that amendment had no bearing on the labelling requirement about which Canada had complained. The statute imposed a mandatory requirement on all producers, and did not provide administrative authorities with any discretion to waive its application. The **Missouri** prohibitions against selling non-intoxicating beer and beer having an alcohol content above 3.2 per cent in the same premises and against the holder of a nonintoxicating beer license holding a license to sell beer over 3.2 per cent alcohol both dated from 1935 and were mandatory. The **Utah** provisions permitting in-state manufacturers to sell light beer directly to retailers dated from 1943, as had been indicated in paragraph 3.92 above. The United States arguments with respect to the Protocol of Provisional Application in paragraphs 3.81 and 3.83 above applied equally here.

3.131 With respect to **Oklahoma**, Canada noted that some of the provisions were not mandatory as they were definitions or did not make the issuance of a license mandatory. Furthermore, amendments subsequent to 1947 had increased the level of discrimination. The **Missouri** provisions with respect to alcoholic content were not mandatory in character. Canada recalled its arguments with respect to the **Utah** provisions in paragraph 3.93 above, and noted the applicability of its previous arguments with respect to the Protocol of Provisional Application.

Article XXIV:12

3.132 The United States presented its view that Article XXIV:12 applied as a matter of course in a dispute in which the defending Contracting Party was a federal state. Identification of particular measures which might be reasonably available to the Federal Government of the United States to ensure observance of the provisions of the General Agreement by state governments would depend on the scope and content of the Panel's findings, as well as on the practice and the state involved. However, the United States would need more time to implement Panel findings that necessitated a change in state practices than would a contracting party that did not have a federal structure.

3.133 Canada indicated that if a state measure was found to be inconsistent with the provisions of the General Agreement, the United States had the obligation under Article XXIV:12 to take such reasonable measures as might be available to it to ensure the observance of the provisions of the General Agreement by the state. Canada drew the attention of the Panel to an article by Dr. Hudec, "The Legal Status of the GATT in the Domestic Law of the United States", in which he stated that the weight of the evidence favoured the view that Article XXIV:12 obligated the United States to compel state adherence to the GATT, and that GATT was thus superior to state law. Accordingly, the invocation of Article XXIV:12 only served to require that in its recommendations, the Panel direct the United States to take such reasonable measures as were available to it to bring inconsistent state measures into conformity with the General Agreement within a given timeframe and to report to the GATT Council at a fixed date on the measures it had taken. In the absence of any progress by that date, it would remain for the CONTRACTING PARTIES to determine whether the United States had met its obligations under Article XXIV:12.

4. THIRD PARTY SUBMISSIONS

Australia

4.1 Australia indicated that the United States market was of considerable importance to Australian beer and wine exporters. In 1990, Australia sent a third of its total beer exports to the United States, with exports of about 9,100,000 litres a year. The excise tax exemption for small domestic producers placed Australian exporters at a disadvantage. As Australia's wine and beer exporters faced a higher excise tax than some domestic producers, the ability of Australian product to compete effectively with the like domestic product was significantly reduced. The higher tax for imported product was proving to be a significant factor in the market when incorporated into retail prices, and pushed the price for many Australian wines into the next higher price bracket. This was particularly the case for wines that were sold at retail under $12 per bottle (the bulk of Australian wines to the United States market). The tax had also placed limitations on the ability of Australian exporters to expand in the market.

4.2 Australia argued that this legislation, and the regulations to implement it, discriminated against foreign suppliers in a manner which adversely affected Australia's trade and was inconsistent with United States national treatment obligations. The provisions under which only goods of United States origin were eligible for a credit from a direct tax were contrary to Article III:2. Panels had consistently found that Article III:2 obliged contracting parties to establish certain competitive conditions for imported products in relation to domestic products. The drafting history confirmed that Article III:2 was designed with "the intention that internal taxes on goods should not be used as a means of protection". (United Nations Conference on Trade and Employment, Reports of Committees, 1948, page 61). This purpose of Article III:2 of promoting non-discriminatory competition among imported and like domestic products could not be achieved if Article III:2 were construed in a manner allowing discriminatory and protective internal taxation of imported products in excess of like domestic products.

4.3 Subsequent GATT practice in the application of Article III further showed that past GATT Panels had examined Article III:2 (and 4) by determining, firstly, whether the imported and domestic products concerned were "like" and, secondly, whether the internal taxation or other regulation discriminated against the imported products. The term "like product" was not defined in the GATT and Panels had been consistent in not defining it except on a case-by-case basis. The criteria for measuring "likeness" in previous panel cases had included: practices of other contracting parties, the physical origin and properties of the product, traditional tariff treatment, treatment of the products in internal regulations by the importing country, and the end use of the product. On the basis of each of these criteria, no distinction could be drawn between beer imported from third countries and beer produced domestically. The same was true of domestically-produced and imported wine. The amount of production output was not a valid criteria upon which to differentiate between products. Any differentiation in tax levels for like products based on annual production levels therefore constituted discrimination against like imported products and was in violation of Article III:2. The Panel on United States - Taxes on Petroleum and Certain Imported Substances (BISD 34S/136), found that a rate of tax for domestic products which was less than that for imported products was contrary to Article III:2.

4.4 Australia further argued that the tax credit granted to domestic producers also violated Article III:4 in that it constituted less favourable treatment for imported products. The Panel on Italian Discrimination against Imported Agricultural Machinery (BISD 7S/60) noted that "any favourable treatment granted to domestic products would have to be granted to like imported products". The Panel on European Economic Community - Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins (BISD 37S/86) noted that violations of Article III occurred when regulations were capable of giving rise to discrimination against imported products although they might not necessarily do so in all individual cases. The Panel found that exposure of a particular imported product to a risk of discrimination constituted, by itself, a form of discrimination. The Panel therefore concluded that purchase regulations creating such a risk must be considered to be according less favourable treatment within the meaning of Article III:4. The granting of an excise tax credit only to domestic producers of wine and beer constituted discrimination or the risk thereof and therefore violated Articles III:2 and III:4 - nullifying and impairing Australia's benefits under the General Agreement.

4.5 Australia maintained that the United States could not claim compliance with Article III:8 since the tax credit was not a subsidy to domestic producers. The credit granted to domestic producers took the form of a decreased rate of tax. Article III:8 allowed subsidies to be granted from the proceeds of internal taxes but it did not allow protection through decreased tax rates so that taxes paid by domestic producers at first instance were less than that paid by importers. If this were not the case, it would be impossible to meet the requirement that internal taxes be levied consistent with the national treatment provisions of Article III, as required by Article III:8(b). Indeed, the drafting history showed that paragraph 8(b) was redrafted in order to make it clear that nothing in this paragraph could be construed to sanction the exemption of domestic products from internal taxes imposed on like products or the remission of such taxes. However, nothing in it would override the provisions of Article XVI. (Havana Reports p.66.)

4.6 Australia further argued that irrespective of whether the tax credit system was consistent with Article III, the imposition of differential excise duties for like domestic and imported products had nevertheless nullified and impaired the tariff bindings on beer and wine in the United States tariff schedule, contrary to Article XXIII:1(b). The current tariff concessions on beer and wine were incorporated into the United States Schedule XX after the negotiations surrounding conversion to the Harmonised System in 1988. It was reasonable for the CONTRACTING PARTIES to expect that, when the concessions for beer and wine were incorporated into the United States Schedule, the United States would not introduce a tax credit system for domestic producers which would counteract the benefit of the tariff concessions. The purpose of Article XXIII was to protect the balance of benefits

accruing under the General Agreement, including the benefit of tariff concessions. The main value of a tariff concession was that it provided an assurance of better market access through improved price competition. In the past Article XXIII:1(b) cases, the CONTRACTING PARTIES' findings of nullification or impairment were based on a finding that the products for which a tariff concession had been granted were subjected to an adverse change in competitive conditions. Contracting parties had the right of redress when a reciprocal concession was impaired by another contracting party as a result of any measure whether or not it conflicted with the General Agreement. The value of the United States tariff concessions for beer and wine were greatly diminished by the granting of a tax credit to some domestic alcoholic beverages but not to any imported like products. The result was a differential excise for domestic and imported products which amounted to treatment less favourable to imported products, and therefore upset the competitive relationship between them.

The European Community

4.7 The European Community observed that the Omnibus Budget Reconciliation Act of 1990 created a new tax exemption for domestic wine producers and augmented the exemption provided to small domestic beer producers. In practice, this measure provided a maximum total benefit of $660,000 per eligible brewery (of which, it had been estimated, there were more than 200 in the United States) and of $90,000 per winery (of which there were 1,400 estimated beneficiaries). The European Community invited the Panel to find that to the extent that these tax exemptions were solely available to qualifying "small" domestic producers and not to third country producers, they were contrary to Article III:2, first sentence, of the General Agreement. Furthermore, the provision acted to afford protection to the product of small domestic producers and therefore was also contrary to Article III:2, second sentence in conjunction with Article III:1 of the General Agreement. As such these measures nullified or impaired benefits accruing to the European Community under the General Agreement.

New Zealand

4.8 New Zealand stated that it had important interests in the United States beer and wine markets. New Zealand's largest brewery exported US$4.21 million to the United States annually, about 40 per cent of its total beer exports. The United States was a key market for further development of New Zealand beer exports. Exports of New Zealand wine to the United States amounted to approximately US$623,000 for the year to 30 June 1991. New Zealand believed that the United States market would become increasingly important to New Zealand exporters in the next few years. New Zealand's ability to export competitively to that market would be restricted, however, if the existing discriminatory measures were maintained.

4.9 New Zealand argued that the lower Federal excise tax rate for the product of certain United States breweries was contrary to the United States' obligations under the General Agreement. It afforded protection to domestic production inconsistent with Article III:1 and contrary to Article III:2 second sentence, and was a prima facie case of nullification or impairment of benefits accruing to New Zealand directly or indirectly under the General Agreement. Imported New Zealand beer and domestic United States beer were like products; they shared similar properties, end-uses and uniform tariff classifications. New Zealand and United States domestically produced beers were, furthermore, directly competitive or substitutable products in terms of the Interpretive Note to Article III:2. The Interpretive Note to Article III made it clear that any internal tax (or other charge) referred to in paragraph 1 which was collected or enforced in the case of imported products at the time or point of importation was nevertheless to be regarded as an internal tax (or other charge) and was accordingly subject to the provisions of Article III. Furthermore, the measure was an internal tax or other internal charge in excess of those applied to like domestic products, because certain United States beers attracted excise tax of only US$7 per barrel while imported beers faced US$18 per barrel excise tax.

4.10 The federal tax measure acted to afford protection to domestic production against imported beer products, particularly in the speciality beer sub-market, inconsistent with Article III:1 and contrary to Article III:2 second sentence. New Zealand's main export to the United States was premium beer which sold primarily in the speciality beers sub-market, competing especially with United States beers produced by small "boutique" breweries. There were around 249 such breweries in the United States whose annual production did not exceed 2 million barrels each, thereby qualifying them for the reduced excise taxes. The New Zealand product competed directly against the products of these producers, and so was accorded treatment less favourable than that accorded to like domestic products.

4.11 The United States measure affected the internal sale or offering for sale of imported products. From 1 January 1991, excise taxes on New Zealand beer imported into the United States doubled to US$1.30 per case; the domestic United States product continued to enjoy a lower excise tax rate of around US$0.51 per case for qualified producers. Price differentials became even more significant at retail level. On a less than standard 25 per cent margin at wholesale and retail level, imported beers would cost an additional US$1.25 per case in comparison to domestic product. New Zealand further argued that the treatment accorded imported products did not meet the "no less favourable" standard of Article III:4. In addition this measure constituted a prima facie case of nullification or impairment of benefits accruing to New Zealand under the General Agreement.

4.12 With respect to wine, New Zealand argued that imported New Zealand wine and domestically produced United States wine were like products. Minor differences in colour and other properties connected with the country of origin of a wine did not prevent products from qualifying as like products. The Japan Alcoholic Beverages Panel had found, for example, that imported and Japanese made still wines were like products in view of their similar properties, end-uses and usually uniform tariff classifications. New Zealand further argued that if imported and domestic wines were not considered to be "like" products, they were at least directly competitive or substitutable products in terms of Article III:2 and the Interpretive Note to Article III:2. Both the increased excise taxes and the excise taxes as reduced by the credit, were internal taxes or other charges in terms of Article III:2. In turn, this meant that the increased excise tax was an internal tax or other charge in excess of that applied to products which enjoyed the tax credit.

4.13 New Zealand argued that the tax credit was not allowable as a subsidy under Article III:8(b). The Havana Reports (page 66) had said that paragraph 8(b) had been redrafted to make it clear that nothing in Article III could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. If the credit were allowed as a subsidy, that would sanction remission of a tax (the increased wine excise tax) which was imposed on like imported wines which otherwise would satisfy the conditions for the tax credit. In addition, New Zealand argued in terms of Article XXIII:1 that whether or not the United States measure conflicts with the provisions of the General Agreement, it constituted a case of nullification or impairment of benefits accruing to New Zealand under the General Agreement. In particular, the measure had been introduced (in 1990 legislation) subsequent to negotiation of the United States' tariff concessions on wine and it upset the competitive relationship between the bound product with regard to like or directly competitive products from New Zealand. Imported wines were subject to internal taxes or other charges in excess of those applied, directly or indirectly, to like domestic products. New Zealand also recalled that the Japan Alcoholic Beverages Panel had noted that the prohibition of tax discrimination had been applied in a strict manner "and as excluding a de minimis argument based on allegedly minimal trade effects." The United States tax measures were therefore inconsistent with United States obligations under Article III:2 first sentence.

4.14 In addition, the tax credit acted to afford protection to domestic production and was therefore inconsistent with Article III:1 and contrary to the United States' obligations under Article III:2 second sentence. New Zealand wine exports to the United States competed mainly against other small, high

quality "boutique" wineries and vineyards. The conditions of competition for New Zealand exports were therefore particularly affected by the federal tax credits because they benefited small domestic United States producers. It was against the products of these small facilities that New Zealand wines primarily competed. In this market, the tax credit afforded protection to domestic production against the similar small volume/high quality imported New Zealand wines.

4.15 Furthermore New Zealand argued that because the tax credit was not available to imported wines on similar terms to wines produced at qualified domestic facilities, the United States measures did not meet the "no less favourable" standard of Article III:4 in respect of all laws, regulations and requirements affecting the internal sale or offering for sale of imported and domestic wine.

4.16 New Zealand maintained that the so-called three-tier distribution system operated by many states did not meet the "no less favourable" standard of Article III:4 in respect of all requirements affecting the internal sale, offering for sale or distribution of like imported and domestic beers. It recalled that the Panel on Canada - Administration of the Foreign Investment Review Act ("FIRA Panel") (BISD 30S/140, paragraph 5.10) found that a requirement which excluded the possibility of purchasing imported products directly from the foreign producer would constitute less favourable treatment and be inconsistent with Article III:4. New Zealand recalled that the FIRA panel interpreted this provision strictly, finding that even where the undertaking was subject to a "competitive availability" qualification, the practice was also contrary to Article III:4 (paragraph 5.11). New Zealand estimated that these state distribution measures imposed additional costs on New Zealand exporters and made the products of New Zealand's largest brewery at least US$8.00 more expensive per case at retail than domestic United States beers. Such state distribution systems were inconsistent with the United States' obligations under Article III:4 of the General Agreement of the GATT.

4.17 Canada noted the arguments by Australia and New Zealand and requested that, if the Panel did not consider Article III:2 to be relevant to the United States tax measures, it examine these measures in the light of Article III:4.

5. FINDINGS

Introduction

5.1 The Panel noted that Canada's complaint was based on the following measures of the United States, claimed by Canada to be inconsistent with Article III: taxation measures at both the federal and state levels which operate to create lower tax rates on domestic beer and wine than on like imported products; requirements in certain states that imported beer and wine be sold only through wholesalers, which requirements do not apply to in-state like products; requirements in certain states that imported beer and wine be transported only by common carrier, which requirements do not apply to in-state like products; higher licensing fees in certain states for imported beer and wine; exemptions in one state of local wine, but not like imported wine, from decisions to prohibit the sale of alcohol within local areas; policies of certain states to fix price levels for imported beer and wine on the basis of prices of those products in other states; listing and delisting policies of states which apply different requirements to imported wine than to the in-state like product[1]; and restrictions in certain states on points of sale, distribution and labelling based on the alcohol content of beer. The Panel noted that Canada also requested the Panel, in the event the Panel were to find the above federal and state tax measures to be in accordance with the provisions of the General Agreement, to conclude that the United States

[1]The Panel noted that Canada maintained in the alternative that these listing and delisting practices were inconsistent with Article XI:1.

measures nullified tariff concessions granted by the United States pursuant to Article II of the General Agreement. The Panel decided to examine successively each of these claims.

Federal Excise Tax Differential on Beer

5.2 The Panel began its examination with Canada's claim that the application of a lower rate of federal excise tax on domestic beer from qualifying (small) United States producers, which lower rate was not available to imported beer, was inconsistent with Articles III:1 and III:2 of the General Agreement. The Panel noted that because Article III:1 is a more general provision than either Article III:2 or III:4, it would not be appropriate for the Panel to consider Canada's Article III:1 allegations to the extent that the Panel were to find United States measures to be inconsistent with the more specific provisions of Articles III:2 and III:4.

5.3 The Panel considered that excise taxes levied on imported and domestic products are internal taxes subject to the national treatment provision of Article III:2, first sentence, which reads:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products".

5.4 In the present case, at least with respect to the federal excise tax issues, the Panel noted the parties' agreement that the excise taxes in question are internal taxes and that imported beer is subject to a higher rate of federal excise tax than domestic beer from qualifying producers. In addition, the record reflected that approximately 1.5 per cent of United States beer production is eligible for the reduced federal tax rate.

5.5 The Panel considered that the application of a lower rate of federal excise tax on domestic beer from qualifying United States producers, which lower rate is not available in the case of imported beer, constitutes less favourable treatment to the imported product in respect of internal taxes and is therefore inconsistent with the national treatment provision of Article III:2, first sentence.

5.6 The Panel noted the United States argument that the total number of barrels currently subject to the lower federal excise tax rate represented less than one per cent of total domestic beer production, that over 99 per cent of United States beer was subject to the same federal excise tax as that imposed on imported beer, and that therefore the federal excise tax neither discriminated against imported beer nor provided protection to domestic production. The Panel further noted that although Canada did not accept the United States estimate that the tax exemption applied to only one per cent of United States production, it pointed out that this figure nonetheless equalled total Canadian exports of beer to the United States. In accordance with previous panel reports adopted by the CONTRACTING PARTIES, the Panel considered that Article III:2 protects competitive conditions between imported and domestic products but does not protect expectations on export volume.[2] In the view of the Panel, the fact that only approximately 1.5 per cent of domestic beer in the United States is eligible for the lower tax rate cannot justify the imposition of higher internal taxes on imported Canadian beer than on competing domestic beer. The prohibition of discriminatory taxes in Article III:2, first sentence, is not conditional on a "trade effects test" nor is it qualified by a de minimis standard. As a previous panel found,

[2]See, for example, the Report of the Panel on "United States - Taxes on Petroleum and Certain Imported Substances", adopted on 17 June 1987, BISD 34S/136, 158; see also the Report of the Panel on "Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages", adopted on 10 November 1987, BISD 34S/83, 114.

> "A change in the competitive relationship contrary to [Article III:2] must consequently be regarded 'ipso facto' as a nullification or impairment of benefits accruing under the General Agreement. A demonstration that a measure inconsistent with Article III:2, first sentence, has no or insignificant effects would therefore in the view of the Panel not be a sufficient demonstration that the benefits accruing under that provision had not been nullified or impaired ...".[3]

Thus, in the view of the Panel, the fact that only approximately 1.5 per cent of domestic beer in the United States is eligible for the lower tax rate does not immunize this United States measure from the national treatment obligation of Article III.

5.7 The Panel then considered the additional argument of the United States that the lower federal excise tax rate was allowable as a subsidy to domestic producers under Article III:8(b). The United States maintained that the clear intent of the lower tax was to subsidize small producers and that reduction in the rate of the excise tax was a GATT-consistent means of providing such a subsidy. The Panel noted that paragraph 8(b) of Article III reads in relevant part:

> "The provisions of this Article shall not prevent the payment of subsidies exclusively to domestic producers, including payments to domestic producers derived from the proceeds of internal taxes or charges applied consistently with the provisions of this Article ...".

5.8 The Panel noted that in contrast to Article III:8(a), where it is stated that "this Article shall not apply to ... [government procurement]", the underlined words are not repeated in Article III:8(b). The ordinary meaning of the text of Article III:8(b), especially the use of the words "shall not prevent", therefore suggests that Article III does apply to subsidies, and that Article III:8(b) only clarifies that the product-related rules in paragraphs 1 through 7 of Article III "shall not prevent the payment of subsidies exclusively to domestic producers" (emphasis added). The words "payment of subsidies" refer only to direct subsidies involving a payment, not to other subsidies such as tax credits or tax reductions. The specific reference to "payments ... derived from the proceeds of internal taxes ... applied consistently with the provisions of this Article" relates to after-tax-collection payments and also suggests that tax credits and reduced tax rates inconsistent with Article III:2, which neither involve a "payment" nor result in "proceeds of internal taxes applied consistently with ... this Article", are not covered by Article III:8(b).

5.9 This textual interpretation is confirmed by the context, declared purpose and drafting history of Article III. The context of Article III shows its close interrelationship with the fundamental GATT provisions in Articles I and II and the deliberate separation of the comprehensive national treatment requirements in Article III from the subsidy rules in Article XVI. The most-favoured-nation requirement in Article I, and also tariff bindings under Article II, would become ineffective without the complementary prohibition in Article III on the use of internal taxation and regulation as a discriminatory non-tariff trade barrier. The additional function of the national treatment requirements in Article III to enhance non-discriminatory conditions of competition between imported and domestic products could likewise not be achieved. As any fiscal burden imposed by discriminatory internal taxes on imported goods is likely to entail a trade-distorting advantage for import-competing domestic producers, the prohibition of discriminatory internal taxes in Article III:2 would be ineffective if discriminatory internal taxes on imported products could be generally justified as subsidies for competing domestic producers in terms of Article III:8(b).

---

[3]Report of the Panel on "United States - Taxes on Petroleum and Certain Imported Substances", adopted on 17 June 1987, BISD 34S/136, 158-59.

5.10 Article III:8(b) limits, therefore, the permissible producer subsidies to "payments" after taxes have been collected or payments otherwise consistent with Article III. This separation of tax rules, e.g. on tax exemptions or reductions, and subsidy rules makes sense economically and politically. Even if the proceeds from non-discriminatory product taxes may be used for subsequent subsidies, the domestic producer, like his foreign competitors, must pay the product taxes due. The separation of tax and subsidy rules contributes to greater transparency. It also may render abuses of tax policies for protectionist purposes more difficult, as in the case where producer aids require additional legislative or governmental decisions in which the different interests involved can be balanced.

5.11 The Panel considered that the drafting history of Article III confirms the above interpretation. The Havana Reports recall in respect of the provision corresponding to Article III:8(b):

> "This sub-paragraph was redrafted in order to make it clear that nothing in Article [III] could be construed to sanction the exemption of domestic products from internal taxes imposed on like imported products or the remission of such taxes. At the same time the Sub- Committee recorded its view that nothing in this sub-paragraph or elsewhere in Article [III] would override the provisions [of Article XVI]".[4]

The drafters of Article III explicitly rejected a proposal by Cuba at the Havana Conference to amend the Article to read:

> "The provisions of this Article shall not preclude the exemption of domestic products from internal taxes as a means of indirect subsidization in the cases covered under Article [XVI]".[5]

5.12 The Panel found, therefore, that the expansive interpretation of Article III:8(b) suggested by the United States is not supported by the text, context, declared purpose and drafting history of Article III and, if carried to its logical conclusion, such an interpretation would virtually eliminate the prohibition in Article III:2 of discriminatory internal taxation by enabling contracting parties to exempt all domestic products from indirect taxes. The Panel accordingly found that the reduced federal excise tax rates on beer are not covered by Article III:8(b).

Federal Excise Tax Credit for Wine

5.13 The Panel then proceeded to examine Canada's claim that the provision of a credit on the federal excise tax for wine and cider of small United States producers, which credit was not similarly available to the like imported products, was contrary to United States obligations under Articles III:1 and III:2. The Panel noted the following: the tax credit for domestic wine and cider applies to the prevailing federal excise tax levied on both the imported and the domestic product; the tax credit is available to domestic wine and cider from wineries producing up to 250,000 wine gallons per year, and is not available to imported wine and cider; and the tax credit is allowable at the time the tax is payable as if the credit constituted a reduction in the rate of the tax.

5.14 The Panel considered that due to the provision of this tax credit to domestic wine and cider, wine and cider imported from Canada is "subject … to internal taxes … in excess of those applied … to like domestic products", inconsistent with Article III:2, first sentence. The Panel considered that this inconsistency with the national treatment provision of Article III:2 also applies to floor stocks of wine eligible for the federal tax credit because these products may yet enter the market on competitive terms not available to like imported products.

---

[4]Havana Reports, page 66.
[5]E/CONF.2/C.3/6, page 17; E/CONF.2/C.3/A/W.32, page 2.

5.15 The Panel noted the United States contention that the number of United States wineries qualifying for the tax credit represented less than four per cent of domestic wine production, and thus the law did not have a discriminatory or protective effect. The United States also argued that the tax credit was allowable as a subsidy under Article III:8(b). The Panel found that its considerations with respect to similar arguments in the context of the lower federal excise tax on domestic beer apply equally here. Accordingly, the Panel found that the provision of a federal excise tax credit on domestic wine and cider, which credit is not available to imported wine and cider, is inconsistent with United States obligations under Article III:2, first sentence, and is not covered by Article III:8(b).

State Excise Tax Differentials Based on Annual Production

5.16 The Panel then examined Canada's claim that the tax laws in the states of **New York**, **Oregon**, **Rhode Island** and the Commonwealth of **Puerto Rico** provided exemptions or reductions of excise taxes to in-state producers of beer and wine based on annual production by these breweries and vintners, below certain limits, and that this treatment resulted in discrimination against imported like products of Canadian brewers and vintners inconsistent with Articles III:1 and III:2. The Panel noted the argument of the United States that the intent of these state tax exemptions or reductions was to provide a subsidy to small producers, consistent with Article III:8(b). The Panel found that as a result of these state tax exemptions or reductions, beer and wine imported from Canada is "subject … to internal taxes … in excess of those applied … to like domestic products", inconsistent with Article III:2, first sentence. With regard to Article III:8(b), the Panel's considerations with respect to the reduced federal excise taxes on domestic beer apply equally to the reduced state excise taxes on domestic beer and wine. Accordingly, the Panel found that the excise tax exemptions and reductions provided by the states of **New York**, **Oregon**, **Rhode Island** and the Commonwealth of **Puerto Rico** to domestic beer and wine, which exemptions and reductions are denied to the imported like products, are inconsistent with Article III:2, first sentence, and are not covered by Article III:8(b).

5.17 The Panel did not consider relevant the fact that many of the state provisions at issue in this dispute provide the same treatment to products of other states of the United States as that provided to foreign products. The national treatment provisions require contracting parties to accord to imported products treatment no less favourable than that accorded to any like domestic product, whatever the domestic origin. Article III consequently requires treatment of imported products no less favourable than that accorded to the most-favoured domestic products.

State Excise Tax Credits Based on Annual Production

5.18 The Panel then considered the claim by Canada that tax credits on state excise taxes provided by the states of **Kentucky**, **Minnesota**, **Ohio** and **Wisconsin** to beer from small domestic breweries based on annual production of these breweries below certain limits, which tax credits were not available to imported beer, were contrary to Articles III:1 and III:2. The Panel recalled the United States argument that the tax credits provided in the states of **Kentucky**, **Ohio** and **Wisconsin** were allowable as subsidies under Article III:8(b). The Panel found that, as the result of the state tax credits in **Kentucky**, **Ohio** and **Wisconsin**, beer imported from Canada is "subject … to internal taxes … in excess of those applied … to like domestic products", inconsistent with Article III:2, first sentence. The Panel also found that its considerations relating to Article III:8(b) with respect to the federal excise tax credit on wine are equally applicable to the state excise tax credits at issue here.

5.19 The Panel further noted that the parties disagreed as to whether or not the tax credits in **Minnesota** were available in the case of imported beer from small foreign breweries. The Panel considered that beer produced by large breweries is not unlike beer produced by small breweries. Indeed, the United States did not assert that the size of the breweries affected the nature of the beer produced or otherwise affected beer as a product. Therefore, in the view of the Panel, even if Minnesota were

to grant the tax credits on a non-discriminatory basis to small breweries inside and outside the United States, imported beer from large breweries would be "subject … to internal taxes … in excess of those applied … to like domestic products" from small breweries and there would still be an inconsistency with Article III:2, first sentence. Accordingly, the Panel found that the state excise tax credits provided by **Kentucky**, **Minnesota**, **Ohio** and **Wisconsin** to domestic breweries based on annual beer production, but not to imported beer, are inconsistent with Article III:2, first sentence.

State Excise Tax Rates Based on Origin of Product

5.20 The Panel next examined the claim by Canada that the lower excise tax rate or tax exemption provided by the states of **Alabama**, **Georgia**, **Iowa**, **Nebraska** and **New Mexico** to wine based upon the in-state or domestic origin of the product was contrary to Articles III:1 and III:2. The Panel recalled the United States arguments that the lower excise tax rates and tax exemptions in the states of Alabama, Georgia, Nebraska and New Mexico were allowable as subsidies under Article III:8(b), and that the state of Iowa applied the same tax rate to wine from all sources sold at wholesale. For the same reasons as those enunciated with respect to the federal excise tax on beer, the Panel found that the application of differential state excise tax rates in the states of **Alabama**, **Georgia**, **Nebraska** and **New Mexico** based upon the origin of the wine, which discriminates against imported wine in favour of the domestic like product, is inconsistent with Article III:2, first sentence. Also, for the same reasons enunciated earlier, the Panel found that the state tax measures in issue are not allowable as subsidies under Article III:8(b).

5.21 With respect to **Iowa**, the Panel noted that the same rate of tax applies to all wine sold at wholesale, regardless of source. However, whereas imported wine is required to be sold through wholesalers, wine produced in Iowa is permitted to be sold directly at retail. As a consequence, imported wine from Canada is "subject … to internal taxes … in excess of those applied … to like domestic products" produced in Iowa whenever the Iowa wine is sold directly at retail without being subject to the wine gallonage tax. This less favourable treatment is inconsistent with Article III:2, first sentence.

State Excise Tax Treatment Based on Local Ingredients

5.22 The Panel then examined Canada's claim that the states of **Michigan**, **Ohio** and **Rhode Island** granted tax exemptions or tax credits to wines produced within the respective states using local ingredients. The Panel found that these tax measures are not available to like wines imported from Canada which are consequently "subject … to internal taxes … in excess of those applied … to like domestic products", contrary to Article III:2, first sentence. The Panel recalled the United States argument that these state tax measures were allowable under Article III:8(b). The Panel further recalled its previous finding that Article III:8(b) cannot justify discriminatory tax exemptions or tax credits inconsistent with Article III:2. The preferential tax treatment accorded by **Michigan**, **Ohio** and **Rhode Island** to wine produced from local ingredients is thus inconsistent with Article III:2, first sentence, and cannot be regarded as a subsidy falling under Article III:8(b).

State Excise Tax on Wine Made From a Specified Variety of Grape

5.23 The Panel then examined the claim by Canada that the state of **Mississippi** applied a lower tax rate to wines in which a certain variety of grape was used, contrary to Articles III:1 and III:2. The Panel recalled the United States argument that the tax provision in Mississippi was applicable to all qualifying wine produced from the specified variety of grape, regardless of the point of origin.

5.24 The Panel considered that Canada's claim depends upon whether wine imported from Canada is "like" the domestic wine in **Mississippi** made from the specified variety of grape, within the meaning of Article III:2. In this regard, the Panel noted that the CONTRACTING PARTIES have not developed

a general definition of the term "like products", either within the context of Article III or in respect of other Articles of the General Agreement. Past decisions on this question have been made on a case-by-case basis after examining a number of relevant criteria, such as the product's end-uses in a given market, consumers tastes and habits, and the product's properties, nature and quality.[6] The Panel considered that the like product determination under Article III:2 also should have regard to the purpose of the Article.

5.25 The basic purpose of Article III is to ensure, as emphasized in Article III:1,

> "that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, purchase, transportation, distribution or use of products … should not be applied to imported or domestic products so as to afford protection to domestic production".

The purpose of Article III is thus not to prevent contracting parties from using their fiscal and regulatory powers for purposes other than to afford protection to domestic production. Specifically, the purpose of Article III is not to prevent contracting parties from differentiating between different product categories for policy purposes unrelated to the protection of domestic production. The Panel considered that the limited purpose of Article III has to be taken into account in interpreting the term "like products" in this Article. Consequently, in determining whether two products subject to different treatment are like products, it is necessary to consider whether such product differentiation is being made "so as to afford protection to domestic production". While the analysis of "like products" in terms of Article III:2 must take into consideration this objective of Article III, the Panel wished to emphasize that such an analysis would be without prejudice to the "like product" concepts in other provisions of the General Agreement, which might have different objectives and which might therefore also require different interpretations.

5.26 Applying the above considerations to the **Mississippi** wine tax, the Panel noted that the special tax treatment accorded in the Mississippi law to wine produced from a particular type of grape, which grows only in the southeastern United States and the Mediterranean region, is a rather exceptional basis for a tax distinction. Given the limited growing range of the specific variety of grape, at least in North America, the Panel was of the view that this particular tax treatment implies a geographical distinction which affords protection to local production of wine to the disadvantage of wine produced where this type of grape cannot be grown. The Panel noted that a previous panel concerning Article III treatment of wines and alcoholic beverages found imported and Japanese unsweetened still wines to be like products.[7] The Panel agreed with the reasoning of this previous panel and was of the view that tariff nomenclatures and tax laws, including those at the United States federal and state level, do not generally make such a distinction between still wines on the basis of the variety of grape used in their production. The Panel noted that the United States did not claim any public policy purpose for this Mississippi tax provision other than to subsidize small local producers. The Panel concluded that unsweetened still wines are like products and that the particular distinction in the Mississippi law in favour of still wine of a local variety must be presumed, on the basis of the evidence submitted to the Panel, to afford protection to Mississippi vintners. Accordingly, the Panel found that the lower rate of excise tax applied by **Mississippi** to wine produced from the specified variety of grape, which lower rate is not available to the imported like product from Canada, is inconsistent with Article III:2, first sentence. The Panel wished to point out that even if the wine produced from the special variety of grape were considered unlike other wine, the two kinds of wine would nevertheless have to be

---

[6]See the Report of the Panel on "Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages", adopted on 10 November 1987, BISD 34S/83, 115.

[7]Report of the Panel on "Japan - Customs Duties, Taxes and Labelling Practices on Imported Wines and Alcoholic Beverages", adopted on 10 November 1987, BISD 34S/83, 115-16.

regarded as "directly competitive" products in terms of the Interpretive Note to Article III:2, second sentence, and the imposition of a higher tax on directly competing imported wine so as to afford protection to domestic production would be inconsistent with that provision.

State Tax Credits for Equipment Purchases

5.27 The Panel then examined Canada's claim that the provision by the state of **Pennsylvania** to in-state breweries of a tax credit on the internal state tax applicable to beer for the purchase of equipment for use in the manufacture of beer was inconsistent with Articles III:1 and III:2. The Panel found that the tax credit results in a lower effective rate of tax for the beer of Pennsylvanian breweries qualifying for the credit, and this credit is not available to beer from Canadian breweries. The Panel recalled the United States argument that this Pennsylvania tax credit was allowable as a subsidy under Article III:8(b). For the same reasons as those enunciated by the Panel with respect to the federal excise tax credit, the Panel found that the provision of this state tax credit to domestic breweries is inconsistent with Article III:2, first sentence, and is not allowable as a subsidy under Article III:8(b).

Non-Violation Nullification or Impairment

5.28 The Panel recalled Canada's subsidiary argument with respect to the federal and state tax measures, that these United States measures nullified or impaired tariff concessions on beer, wine and cider granted by the United States pursuant to Article II. The Panel further recalled the United States argument that Canada had neither consulted on nor provided a detailed justification of its allegations of non-violation nullification or impairment. However, in view of the fact that the Panel found violations of Article III:2 with respect to the federal and state tax measures of the United States, the Panel did not consider it necessary to address this alternative allegation of non-violation nullification or impairment.

Exemptions of Local Producers from State Requirements to Use Wholesalers

(i) Article III

5.29 The Panel then proceeded to examine the claim by Canada that the states of **Alaska**, **California**, **Connecticut**, **Florida**, **Hawaii**, **Idaho**, **Illinois**, **Indiana**, **Iowa**, **Kansas**, **Kentucky**, **Louisiana**, **Maine**, **Maryland**, **Massachusetts**, **Minnesota**, **Missouri**, **Montana**, **New Hampshire**, **Ohio**, **Oregon**, **Pennsylvania**, **Rhode Island**, **Tennessee**, **Texas**, **Utah**, **Virginia**, **Washington**, **West Virginia** and **Wisconsin** imposed the requirement that imported beer and wine be sold only through in-state wholesalers or other middlemen, while permitting some in-state like products to be sold directly to retailers, and in some cases at retail on producers' premises, inconsistent with Articles III:1 and III:4. The Panel noted the Canadian position that the requirement that imported wine and beer be shipped through in-state wholesalers discriminated against imported product by creating an additional level of distribution and expense and by providing less access for in-state retailers to imported product than that afforded to the like product manufactured in-state. The Panel further noted the United States arguments that the three-tier separation of production, wholesale distribution and retail sales of liquor served legitimate state interests in the efficient collection of excise taxes and the promotion of health and safety; that the requirement on out-of-state and foreign beer and wine producers to use wholesalers was necessary to ensure enforcement of state excise tax laws; that such requirement did not discriminate in favour of the domestic like product; that distribution through wholesalers was the "preferred" method of distribution; that Canadian producers could establish their own in-state wholesalers in a number of states; and that in-state breweries and wineries exempted from the wholesaler requirement nevertheless bore the same costs as imports subject to this requirement, in terms of record keeping, audit, inspection and tax collection.

5.30 The Panel noted that Article III:4 reads in relevant part:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use".

The Panel recalled that the CONTRACTING PARTIES have consistently interpreted the requirement of Article III:4 to accord imported products treatment no less favourable than that accorded to domestic products as a requirement to accord imported products competitive opportunities no less favourable than those accorded to domestic products.[8]

5.31 The Panel considered as irrelevant to the examination under Article III:4 the fact that many -- or even most -- in-state beer and wine producers "preferred" to use wholesalers rather than to market their products directly to retailers. The Article III:4 requirement is one addressed to relative competitive opportunities created by the government in the market, not to the actual choices made by enterprises in that market. Producers located in the states in question have the opportunity to choose their preferred method of marketing. The Panel considered that it is the very denial of this opportunity in the case of imported products which constitutes less favourable treatment. The Panel then recalled the finding of a previous panel[9] that a requirement to buy from domestic suppliers rather than from the foreign producer was inconsistent with Article III:4:

> "The Panel recognized that these requirements might in a number of cases have little or no effect on the choice between imported and domestic products. However, the possibility of purchasing imported products directly from the foreign producer would be excluded and as the conditions of purchasing imported products through a Canadian agent or importer would normally be less advantageous, the imported product would therefore have more difficulty in competing with Canadian products (which are not subject to similar requirements affecting their sale) and be treated less favourably".[10] (emphasis in the original)

Similarly, in the present case the Panel considered that the choice available to some United States producers to ship their beer and wine directly to in-state retailers may provide such domestic beer and wine with competitive opportunities denied to the like imported products. Even if in some cases the in-state exemption from the wholesaler requirement is available only to small wineries and small breweries, this fact does not in any way negate the denial of competitive opportunities to the like imported products. In so finding, the Panel recalled its earlier finding, in paragraph 5.19, that beer from large breweries is not unlike beer from small breweries.

5.32 In the view of the Panel, therefore, the requirement that imported beer and wine be distributed through in-state wholesalers or other middlemen, when no such obligation to distribute through wholesalers exists with respect to in-state like domestic products, results in "treatment … less favourable than that accorded to like products" from domestic producers, inconsistent with Article III:4. The Panel considered that even where Canadian producers have the right to establish in-state wholesalers,

---

[8]See, for example, the Report of the Panel on "United States - Section 337 of the Tariff Act of 1930", adopted on 7 November 1989, BISD 36S/345, 386; and the Report of the Panel on "Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies", [not yet considered by the Council,] DS17/R, page 55.

[9]Report of the Panel on "Canada - Administration of the Foreign Investment Review Act", adopted on 7 February 1984, BISD 30S/140, 160-61.

[10]Report of the Panel on "Canada - Administration of the Foreign Investment Review Act", adopted on 7 February 1984, BISD 30S/140, 160-61.

as is the case in some states, subject to varying conditions, the fact remains that the wholesale level represents another level of distribution which in-state product is not required to use.

5.33 The Panel recalled the United States argument that the wholesaler requirement in the case of imported beer and wine was non-discriminatory and consistent with Article III:4 because it applied also to out-of-state domestic products. As the Panel previously noted, however, Article III requires treatment of imported products no less favourable than that accorded to the most-favoured domestic products. The Panel also recalled the argument of the United States that the wholesaling requirement was consistent with Article III:4 because in-state breweries and wineries not subject to the wholesaling requirement bore the same costs as did wholesalers in respect of record keeping, audit, inspection and tax collection. The Panel noted that this factual contention -- that imported products are not in fact disadvantaged vis-à-vis domestic like products in spite of different requirements -- was disputed by Canada and was similar to the position taken by the United States with respect to imported products being subject to the "preferred" wholesaling method of distribution. As previously noted, the Panel considered that the inconsistency with Article III:4 stems from the denial to the imported products of competitive opportunities accorded to the domestic like products. Whereas domestic beer and wine may be shipped directly from the in-state producer to the retailer, or sold directly at retail, this competitive advantage is denied to imported beer and wine.

5.34 With respect to **California**, the Panel noted that foreign produced beer and wine can either be imported by a licensed importer for sale to a wholesaler, or, alternatively, although the evidence submitted is not clear on this point, foreign producers may be able to sell their product directly at retail from their own outlets in the state. In-state producers, in contrast, can sell to anyone licensed to sell beer and wine, whether wholesaler or retailer, or at retail at their own outlets. The Panel considered that despite the fact that imported beer and wine in California might be sold directly at retail, it nevertheless is denied the full range of competitive opportunities accorded to domestic like products, inconsistent with Article III:4.

5.35 The Panel noted that in **New Hampshire** neither in-state brewers nor foreign brewers can obtain wholesale licenses and so neither can sell directly to retailers. However, the information available to the Panel indicated that whereas New Hampshire brewers can sell directly to wholesalers, foreign beer can be imported only by the holder of a beverage importer's license, who can then sell the beer only to wholesalers. A foreign brewer cannot directly obtain a beverage importer's license for his foreign-based corporation, but may establish a corporation in the United States which could be licensed. As with the distribution requirements examined by the Panel in paragraph 5.33 above, the Panel considered that the effect of this requirement is that Canadian beer faces an additional level of distribution which in-state beer is not required to use.

5.36 With respect to **Kentucky**, the Panel noted that one statute permits retail licensees in Kentucky to purchase beer directly from brewers, without further stipulation as to the location of such brewers. The Panel also observed that a separate statute expressly grants licensed distributors the right to buy foreign beer from importers or wholesalers registered in Kentucky. However, the Panel considered that the evidence does not support a conclusion refuting the claim by the United States that foreign breweries can sell beer directly to retailers in Kentucky.

5.37 The Panel further noted that the **Missouri** regulations permit retailers to purchase beer containing more than 3.2 per cent alcohol only from wholesalers. Both Missouri breweries and foreign breweries can obtain wholesale licenses, although a foreign brewery is required to have an employee resident in Missouri eligible to receive such a license. The Panel considered that this distinction does not support a conclusion that beer imported from Canada is accorded treatment less favourable than beer produced in Missouri.

5.38 Accordingly, the Panel found that the requirement in the states of **Alaska** (for beer and wine), **California** (beer and wine), **Connecticut** (beer and wine), **Florida** (beer and wine), **Hawaii** (beer and wine), **Idaho** (beer), **Illinois** (beer), **Indiana** (beer and wine), **Iowa** (beer and wine), **Kansas** (beer and wine), **Louisiana** (beer and wine), **Maine** (beer and wine), **Maryland** (beer and wine), **Massachusetts** (beer and wine), **Minnesota** (beer and wine), **Montana** (beer), **New Hampshire** (beer and wine), **Ohio** (beer and wine), **Oregon** (beer and wine), **Pennsylvania** (beer and wine), **Rhode Island** (beer and wine), **Tennessee** (beer), **Texas** (beer and wine), **Utah** (beer containing not more than 3.2 per cent alcohol by weight), **Virginia** (beer), **Washington** (beer and wine), **West Virginia** (wine), and **Wisconsin** (beer and wine) that imported beer and/or wine be sold only through wholesalers or other middlemen, which requirement does not apply to domestic like products that may be sold directly to retailers or directly at retail, is inconsistent with Article III:4.

(ii) Non-Enforcement

5.39 The Panel then proceeded to consider the United States argument that the provisions in the state of **Illinois** permitting manufacturers to sell directly to retailers were not given effect. In this regard, the Panel recalled the decisions of the CONTRACTING PARTIES on the relevance of the non-application of laws in dispute. Recent panels addressing the issue of mandatory versus discretionary legislation in the context of both Articles III:2 and III:4[11] concluded that legislation mandatorily requiring the executive authority to take action inconsistent with the General Agreement would be inconsistent with Article III, whether or not the legislation were being applied, whereas legislation merely giving the executive authority the possibility to act inconsistently with Article III would not, by itself, constitute a violation of that Article. The Panel agreed with the above reasoning and concluded that because the **Illinois** legislation in issue allows a holder of a manufacturer's license to sell beer to retailers, without allowing imported beer to be sold directly to retailers, the legislation mandates governmental action inconsistent with Article III:4.

(iii) Article XX(d)

5.40 The Panel then recalled the United States alternative argument that the requirement that imported beer be distributed through in-state wholesalers, which requirement was not imposed in the case of beer from in-state breweries, was justified under Article XX(d) as a measure necessary to secure compliance with laws or regulations which were not inconsistent with the provisions of the General Agreement.

5.41 The Panel noted that Article XX(d) provides in relevant part:

> "Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any contracting party of measures: … (d) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement …".

[11]Report of the Panel on "Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes", adopted on 7 November 1990, BISD 37S/200, 227; Report of the Panel on "EEC - Regulation on Imports of Parts and Components", adopted on 16 May 1990, BISD 37S/132, 198; and Report of the Panel on "United States - Taxes on Petroleum and Certain Imported Substances", adopted on 17 June 1987, BISD 34S/136, 160.

The Panel noted that in addition to the requirements of the introductory section of Article XX, sub-paragraph (d) of the Article requires a showing (i) that the laws or regulations with which compliance is being secured are not inconsistent with the General Agreement, and (ii) that the measures in question -- not measures generally -- are necessary to secure compliance with those laws or regulations. The Panel also noted the practice of the CONTRACTING PARTIES of interpreting these Article XX exceptions narrowly, placing the burden on the party invoking an exception to justify its use.

5.42 The Panel recalled the position of the United States that there was no reasonable alternative to the existing regulatory scheme in the various states which required out-of-state and imported beer to be distributed to retailers via in-state wholesalers while allowing in-state beer to be shipped directly from producers to retailers. The United States considered that the wholesaler was the only reasonable place for beer excise taxes to be collected for out-of-state and foreign products, but that there was no such necessity with respect to products from in-state producers that were, by definition, under the jurisdiction of the state. The Panel further recalled the position of Canada that the burden was on the United States to specify and demonstrate the consistency with the General Agreement of the laws for which it was trying to secure compliance and to show that there were no less trade restrictive measures available to secure compliance with them.

5.43 The Panel was of the view that even if, as argued by the United States, the requirement to use wholesalers is considered as a "measure to secure compliance" in terms of Article XX(d) and the respective state liquor laws are considered as "laws … not inconsistent with the provisions of this Agreement" notwithstanding the above-mentioned Panel findings on inconsistency with Article III, the United States has not demonstrated that discriminatory requirements to use wholesalers are "necessary" in terms of Article XX(d) to enforce the liquor tax laws. The Panel recalled the finding of an earlier panel "that a contracting party cannot justify a measure inconsistent with another GATT provision as 'necessary' in terms of Article XX(d) if an alternative measure which it could reasonably be expected to employ and which is not inconsistent with other GATT provisions is available to it".[12] The Panel considered that the United States has not met its burden of showing that the specific inconsistency with Article III:4 of the discriminatory wholesaler requirements in the various states is the only reasonable measure available to secure enforcement of state excise tax laws. The fact that not all fifty states maintain discriminatory distribution systems indicates to the Panel that alternative measures for enforcement of state excise tax laws do indeed exist. Assuming that the United States was correct in stating that hardly any domestic in-state breweries exercise the privilege of selling directly to retailers, the Panel considered this was further evidence that a discriminatory wholesaler requirement, imposed only on imported and out-of-state products, is not "necessary" within the meaning of Article XX(d). Based on the evidence submitted to it, the Panel found that the United States has not shown that the inconsistency with Article III:4 of the wholesaler requirement on imported beer is justified under Article XX(d) as a measure necessary to secure enforcement of state excise tax laws that are consistent with the General Agreement.

(iv) Protocol of Provisional Application

5.44 The Panel then proceeded to examine the United States contention that the state distribution requirements of **Connecticut**, **Florida**, **Maryland**, **Massachusetts**, **Missouri**, **Oregon**, **Texas** and **Utah**, even if inconsistent with Article III, were covered -- "grandfathered" -- by the existing legislation clause of the Protocol of Provisional Application ("PPA"). The Panel first noted that the United States, as the party invoking the PPA, has the burden of demonstrating its applicability in the instant case. The Panel then noted that the PPA provides in relevant part:

[12]Report of the Panel on "United States - Section 337 of the Tariff Act of 1930", adopted on 7 November 1989, BISD 36S/345, 392.

"The Governments of … undertake … to apply provisionally on and after 1 January 1948:
(a) Parts I and III of the General Agreement on Tariffs and Trade, and
(b) Part II of that Agreement to the fullest extent not inconsistent with existing legislation".

It then noted that the Chairman of the CONTRACTING PARTIES ruled in 1949 that the reference date for the phrase "existing legislation" was 30 October 1947, the date of the PPA.[13] It also noted the report of the Working Party on "Modifications to the General Agreement", adopted on 1 September 1948, which recorded agreement of the Working Party that a measure could be permitted during the period of provisional application "provided that the legislation on which it is based is by its terms or expressed intent of a mandatory character -- that is, it imposes on the executive authority requirements which cannot be modified by executive action".[14] The Panel further noted that subsequent GATT practice confirms this early interpretation of the term "existing legislation".[15] The Panel thus considered that the function of the clause was to enable the executive authority of each government signing the PPA to accept the obligations under the General Agreement without first securing a modification or repeal of existing mandatory legislation which was inconsistent with the General Agreement and which could not be modified through executive action.

5.45 The Panel then proceeded to examine the contention of the United States that existing mandatory legislation in the United States included legislation at the state level. The Panel first considered whether, in view of the fact that the United States had accepted the PPA as a federal Executive Agreement, the state distribution requirements concerned could be considered "mandatory legislation" in the sense of the PPA. The Panel noted in this respect that both parties agreed that under United States constitutional law GATT law is part of United States federal law and, being based on the Commerce Clause of the Constitution, overrides, as a general matter, inconsistent state law. This was also the view of two eminent writers on the law of the GATT, Professors John Jackson and Robert Hudec, to whom Canada and the United States referred in their submissions. In his 1969 treatise, World Trade and the Law of GATT, Professor Jackson comments:

"In those nations where it has been settled that valid federal executive regulation is superior to local law, such as the United States, GATT obligates a contracting party's executive to prevent local laws or actions that would violate GATT. Thus it can be concluded that local legislation "existing" at the time GATT was completed was not within the exception of the Protocol of Provisional Application".[16]

And Professor Hudec notes in his 1986 essay on "The Legal Status of GATT in the Domestic Law of the United States":

"Two central conclusions are generally accepted:
(1) The General Agreement is a valid Executive Agreement -- not only valid as an international obligation of the United States, but also valid as a proper exercise of Presidential authority under the domestic law of the United States.

[13]BISD II/35.
[14]BISD II/49, 62.
[15]See, for example, Report of the Panel on "Belgian Family Allowances", adopted on 7 November 1952, BISD 1S/59, 61; Report of the Panel on "United States Manufacturing Clause", adopted on 15/16 May 1984, BISD 31S/74, 88; and Report of the Panel on "Norway - Restrictions on Imports of Apples and Pears", adopted on 22 June 1989, BISD 36S/306, 322.
[16]Jackson, World Trade and the Law of GATT (1969), page 116.

(2) The GATT prevails over state law, but is inferior to federal law".[17]

Professor Hudec also notes the teachings of the United States Supreme Court as follows:

> "An international agreement, validly proclaimed as federal law, is superior to conflicting state law, even if it is not superior to other federal law. The federal government possesses adequate legal power to preempt state law in this manner. It does not matter whether the international agreement is authorized or approved by Congress, because even an Executive Agreement resting solely on the President's foreign affairs power prevails over conflicting state law".[18]

5.46 The Panel considered that assuming that United States federal law, including the GATT as part of federal law, in general overrides inconsistent state legislation, it was still necessary in the present case to examine whether United States federal law, including the GATT, overrides inconsistent state liquor laws based on the Twenty-first Amendment of the United States Constitution which grants substantial regulatory powers to the states in respect of alcoholic beverages. Based on the submissions of the parties, the Panel found that there is evidence supporting the conclusion that this is the case; that is, the Twenty-first Amendment grants broad police powers to the states to regulate the distribution and sale of alcoholic beverages but does not grant the states powers to protect in-state producers of alcoholic beverages against imports of competing like products.

5.47 The Panel noted that this conclusion is supported by various decisions of the United States Supreme Court, to which Canada and the United States referred in their submissions. In Hostetter v. Idlewild, the Supreme Court in 1964 stated:

> "To draw a conclusion … that the Twenty-first Amendment has somehow operated to 'repeal' the Commerce Clause wherever regulation of intoxicating liquors is concerned would … be an absurd oversimplification".[19]

It further observed:

> "Both the Twenty-first Amendment and the Commerce Clause are parts of the same Constitution [and] each must be considered in light of the other and in the context of the issues and interests at stake in any concrete case".[20]

Later, in Bachus Imports, Ltd. v. Dias, Director of Taxation of Hawaii, the Supreme Court ruled:

> "The central purpose of the [Twenty-first Amendment] was not to empower States to favour local liquor industries by erecting barriers to competition. It is also beyond doubt that the Commerce Clause itself furthers strong federal interests in preventing economic Balkanization".[21]

Citing several earlier Supreme Court cases, it went on to conclude:

---

[17]Hudec, "The Legal Status of GATT in the Domestic Law of the United States" in Hilf, Jacobs, Petersmann (eds), The European Community and GATT (1986), page 199.

[18]Hudec, "The Legal Status of GATT in the Domestic Law of the United States" in Hilf, Jacobs, Petersmann (eds), The European Community and GATT (1986), page 219. Professor Hudec cites to the Supreme Court cases of United States v. Belmont, 301 U.S. 324 (1937) and United States v. Pink, 315 U.S. 203 (1942).

[19]Hostetter v. Idlewild, 377 U.S. 324, 331 (1964).

[20]Idem at 332.

[21]Bachus Imports, Ltd. v. Dias, Director of Taxation of Hawaii, 486 U.S. 263, 276 (1984).

> "State laws that constitute mere economic protectionism are therefore not entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor. Here, the State does not seek to justify its tax on the ground that it was designed to promote temperance or to carry out any other purpose of the Twenty-first Amendment, but instead acknowledges that the purpose was 'to promote a local industry.' … Consequently, because the tax violates a central tenet of the Commerce Clause but is not supported by any clear concern of the Twenty-first Amendment, we reject the State's … claim based on the Amendment".[22]

The Supreme Court then ruled in Brown-Forman Distillers Corp. v. New York State Liquor Authority that the Twenty-first Amendment does not immunize state laws from Commerce Clause attack where their practical effect is to regulate liquor sales in other states.[23] And it made a similar ruling in Healy v. Beer Institute, Inc.[24]

5.48 Judging from the evidence submitted to this Panel, and in particular that of the various cases before the United States Supreme Court, the Panel considered that the United States has not demonstrated that its state laws inconsistent with Article III impose requirements which the United States could not change, or indeed has not already overruled, by executive action, including, in this case, acceptance by the United States of the obligations under the General Agreement as part of United States federal law. The Panel thus found that the record does not support the conclusion that the inconsistent state liquor legislation at issue in this proceeding is "mandatory existing legislation" in terms of the PPA.

State Requirements to Use Common Carriers

5.49 The Panel next considered Canada's claim that the states of **Arizona**, **California**, **Maine**, **Mississippi** and **South Carolina** required that alcoholic beverages imported into the state be transported by common carriers authorized to operate as such within the state whereas in-state producers of alcoholic beverages could deliver their product to customers in their own vehicles. Canada considered this difference in treatment of imported and domestic products to be inconsistent with Articles III:1 and III:4. The Panel recalled that the United States did not argue that the common carrier requirement in various states was consistent with Article III, but claimed that it was justified under Article XX(d).

5.50 The Panel noted that Article III:4 requires that imported products be granted treatment no less favourable than that afforded to like domestic products with respect to laws and regulations affecting their transportation. In the view of the Panel, the requirement for imported beer and wine to be transported by common carrier, whereas domestic in-state beer and wine is not so required, may result in additional charges to transport these imported products and therefore prevent imported products from competing on an equal footing with domestic like products. Accordingly, the Panel found the requirement that imported beer and wine be transported by common carrier into the states of **Arizona**, **California**, **Maine**, **Mississippi** and **South Carolina**, which requirement does not exist in such states for in-state beer and wine, is inconsistent with Article III:4.

5.51 The Panel then considered whether or not this common carrier measure could be justified, as claimed by the United States, under Article XX(d). In this regard, the Panel recalled the arguments of the United States that this measure was necessary because it ensured independent record-keeping for shipments of out-of-state alcohol. The United States maintained that such an independent source of records was necessary because the state authorities did not have access to the out-of-state producers' shipping records with which to verify information provided by in-state wholesalers; that such

---

[22]Idem.

[23]Brown-Forman Distillers Corp. v. New York State Liquor Authority, 476 U.S. 573, 585 (1986).

[24]Healy v. Beer Institute, Inc., 109 S.Ct. 2491, 2500-03 (1989).

independent verification was necessary in order to curb tax avoidance; and that because in-state producers were within the jurisdiction of the state tax authorities, there was no reason to require that their beer and wine be shipped by common carrier.

5.52 The Panel was of the view that its considerations with respect to Article XX(d) in relation to the wholesaler requirement apply equally here. It was incumbent upon the United States to demonstrate that particular laws for which compliance is being sought are consistent with the General Agreement and that the inconsistency with Article III:4 of the discriminatory common carrier requirement for imported beer and wine is necessary to secure compliance with those laws. In the view of the Panel, the United States has not demonstrated that the common carrier requirement is the least trade restrictive enforcement measure available to the various states and that less restrictive measures, e.g. record-keeping requirements of retailers and importers, are not sufficient for tax administration purposes. In this regard, the Panel noted that not all fifty states of the United States maintain common carrier requirements. It thus appeared to the Panel that some states have found alternative, and possibly less trade restrictive, and GATT-consistent, ways of enforcing their tax laws. The Panel accordingly found that the United States has not met its burden of proof in respect of its claimed Article XX(d) justification for the common carrier requirement of the various states.

State Licensing Fees

5.53 The Panel next examined the claim by Canada that licensing fees for the sale of beer and wine in the state of **Alaska** and for beer in the state of **Vermont**, which were higher for imported product than for product produced in-state, were inconsistent with United States obligations under Articles III:1, III:2 and III:4. The Panel recalled Canada's argument that the charging of a license fee for foreign beer and wine which exceeded the fee applied to the domestic like product constituted either an internal charge inconsistent with Article III:2 or a requirement providing less favourable treatment to imported products than to like domestic products with respect to their offering for sale within the state, inconsistent with Article III:4. According to Canada, such measures also had the effect of modifying the conditions of competition between the imported and domestic product and afforded protection to domestic production, inconsistent with Article III:1. The Panel further recalled the United States argument, with respect to Alaska only, that Alaskan law imposed the same fee on all wholesalers, and did not distinguish between wholesalers handling in-state and out-of-state or foreign products. The United States also argued that the two Alaskan brewers sold their beer through wholesalers and that, therefore, the wholesaler fees did not discriminate against imported beer.

5.54 With regard to **Alaska**, the Panel noted that the same wholesaler licensing fees are charged whether the product originates in-state or is imported. But in-state producers of beer and wine are not required to sell through wholesalers and may therefore avoid paying the state wholesaler licensing fees, whereas foreign producers may only sell through wholesalers and must therefore pay the state wholesaler licensing fees. It appeared to the Panel, therefore, that with respect to Alaska, the inconsistency with Article III arises not from the levying of the wholesaler license fees as such, but from imposing an obligation on foreign producers of beer and wine to sell only through wholesalers. This discriminatory requirement adversely affects the competitive conditions by enabling in-state producers, but not foreign producers, to avoid the higher licensing fees on sales of beer and wine through wholesalers. The Panel considered that this amounts to "treatment … less favourable than that accorded to like products" of in-state producers, inconsistent with Article III:4, even if Alaskan brewers currently choose to sell their beer through wholesalers.

5.55 With respect to the state of **Vermont**, the Panel noted that the United States did not contest Canada's claim that Vermont applied a higher licensing fee for imported beer than for the like domestic product. On its face, this measure accords less favourable treatment to imported beer than to the like

domestic product. The Panel, therefore, concluded that Vermont's application of a higher licensing fee to imported beer than to the like domestic product is inconsistent with Article III:2, first sentence.

Local Option Laws

5.56 The Panel then proceeded to examine the claim by Canada that the local option law affecting the sale of wine in the state of **Mississippi** discriminated against imported wine, inconsistent with United States obligations under Article III:4. The Panel noted that the local option law in Mississippi permits wines produced in the state to continue to be sold in those political subdivisions of the state that choose to reinstate prohibition laws, while prohibiting out-of-state and imported wines from being sold in those same subdivisions. The Panel considered that the Mississippi local option law, on its face, accords less favourable treatment to imported wine than to wine of domestic origin, because domestic wine produced in-state may continue to be sold even where a local political subdivision prohibits the sale of imported wine. The Mississippi law would therefore appear to be inconsistent with Article III:4.

5.57 The Panel then proceeded to consider the United States argument that the **Mississippi** law was not being applied. In this regard, the Panel recalled its previous discussion of this issue, noting that legislation mandatorily requiring the executive authority to take action inconsistent with the General Agreement would be inconsistent with Article III, whether or not the legislation was currently implemented, whereas legislation merely giving the executive authority the possibility to act inconsistently with Article III would not, by itself, constitute a violation of that Article. The Panel noted that the option law in Mississippi provides discretion only for the reinstatement of prohibition, but not for the discriminatory treatment of imported wines. The Panel concluded, therefore, that because the Mississippi legislation in issue, which permits native wines to be sold in areas of the state which otherwise prohibit the sale of alcoholic beverages, including imported wine, mandates governmental action inconsistent with Article III:4, it is inconsistent with that provision whether or not the political subdivisions are currently making use of their power to reinstate prohibition.

Price Affirmation

5.58 The Panel next examined the claim by Canada that the states of **Massachusetts** and **Rhode Island** imposed price affirmation requirements (maximum price levels) for the sale of imported beer and wine to wholesalers on the basis of the prices of those products in neighbouring states, but exempted the like domestic products from these requirements, inconsistent with Articles III:1 and III:4. The Panel recalled that the United States maintained that Massachusetts did not and would not enforce these measures and that Rhode Island only nominally enforced these measures.

5.59 The Panel noted that the price affirmation measures apply with respect to sales of alcoholic beverages to wholesalers, and that in-state producers are not required to sell through wholesalers whereas out-of-state and foreign producers are required to do so. The Panel recalled its previous finding that the requirement in both **Massachusetts** and **Rhode Island** that imported beer and wine be sold through wholesalers, where no such requirement exists with respect to in-state like products, is inconsistent with Article III:4. The Panel considered that the price affirmation measures of Massachusetts and Rhode Island prevent the imported alcoholic beverages from being priced in accordance with commercial considerations in that imported products may not be offered below the price of these products in neighbouring states. In the view of the Panel, these measures thus accord less favourable treatment to imported products than to the like domestic products with respect to their internal sale and offering for sale, inconsistent with Article III:4.

5.60 In respect of the United States contention that the **Massachusetts** measure was not being enforced and that the **Rhode Island** measure was only nominally enforced, the Panel recalled its discussion of mandatory versus discretionary laws in the previous section. The Panel noted that the price affirmation measures in both Massachusetts and Rhode Island are mandatory legislation. Even if Massachusetts may not currently be using its police powers to enforce this mandatory legislation, the measure continues to be mandatory legislation which may influence the decisions of economic operators. Hence, a non-enforcement of a mandatory law in respect of imported products does not ensure that imported beer and wine are not treated less favourably than like domestic products to which the law does not apply. Similarly, the contention that Rhode Island only "nominally" enforces its mandatory legislation a fortiori does not immunize this measure from Article III:4. The mandatory laws in these two states by their terms treat imported beer and wine less favourably than the like domestic products. Accordingly, the Panel found that the mandatory price affirmation laws in Massachusetts and Rhode Island are inconsistent with Article III:4, irrespective of the extent to which they are being enforced.

State Listing and Delisting Policies

5.61 The Panel then examined the claim by Canada that the listing and delisting practices maintained in the states of **Alabama**, **Idaho**, **Mississippi**, **New Hampshire**, **North Carolina**, **Oregon**, **Pennsylvania**, **Vermont** and **Virginia**, which provided more favourable treatment to domestic wines than the like imported products, were inconsistent with Articles III:4, III:1 and XI:1. The Panel recalled Canada's argument that whereas the listing policies varied substantially among the states, the listing policies in each of these states provided preferential treatment of in-state wine. The Panel also recalled the United States arguments that in the states of **Mississippi**, **Oregon** and **North Carolina**, the wholesale and retail sales of wine were performed by the private sector and were not subjected to listing/delisting requirements; that the listing/delisting policies of **Alabama** and **New Hampshire** did not afford preferential treatment of in-state wines; and that **Vermont** and **Virginia** had extensive systems of private retail outlets where listing/delisting requirements were not applicable, but only a limited number of state outlets. The Panel further recalled that each of these states are "control" states, meaning that they maintain Alcoholic Control Boards or Commissions which import, distribute and sell alcoholic beverages at the retail level. In many of these control states, imported wine must be listed with the state marketing agencies in order to gain access either to the state market or to the state stores. However, the Panel noted that the United States and Canada did not agree on the factual description of the listing/delisting practices of certain of the states.

5.62 The Panel first addressed the issue of whether the listing and delisting claims should be analyzed under Article III:4 or Article XI:1. In this regard, it recalled that this same issue had been addressed by two previous panels in respect of the listing practices and restrictions on points of sale maintained by Canadian provincial liquor boards. The first of these panels considered that where a monopoly existed with respect to importation and distribution, the distinction between Article III and Article XI had little practical significance. It then ruled that the practices of the provincial liquor boards with respect to listing and delisting which discriminated against imported products were measures made effective through state-trading enterprises, contrary to Article XI:1.[25] But the panel went on to state that:

> "… the Panel saw great force in the argument that Article III:4 was also applicable to state-trading enterprises at least when the monopoly of the importation and monopoly of the distribution in the domestic markets were combined, as was the case of the provincial liquor boards in Canada".[26]

[25]Report of the Panel on "Canada - Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies", adopted on 22 March 1988, BISD 35S/37, 89-90.

[26]Idem at 90.

The latter panel considered that the practice in Ontario liquor boards of limiting the listing of imported beer to the six-pack size while according listings in different package sizes to domestic beer was a practice falling under Article III:4 in that it was a requirement that did not affect the importation of beer as such but rather its offering for sale. That panel then ruled that the measure was inconsistent with Article III:4.[27] The same panel "saw great force in the argument that the restrictions on access to points of sale were covered by Article III:4", but went on to find that these point of sale restrictions were contrary to the provisions of the General Agreement, without deciding whether they fell under Article XI:1 or Article III:4.[28]

5.63 Having regard to the past panel decisions and the record in the instant case, the present Panel was of the view that the listing and delisting practices here at issue do not affect importation as such into the United States and should be examined under Article III:4. The Panel further noted that the issue is not whether the practices in the various states affect the right of importation as such, in that they clearly apply to both domestic (out-of-state) and imported wines; rather, the issue is whether the listing and delisting practices accord less favourable treatment -- in terms of competitive opportunities -- to imported wine than that accorded to the like domestic product. Consequently, the Panel decided to analyze the state listing and delisting practices as internal measures under Article III:4.

5.64 The Panel examined the specific measures in each of the states. The Panel noted that in the states of **Mississippi** and **Pennsylvania**, imported wine can be sold at the wholesale and at the retail level, respectively, only by the liquor control boards, whereas domestically-produced wine can be sold directly to retailers. The Panel further noted that in the state of **Idaho**, the liquor control board has the monopoly on the importation of wine, although not on its sale at retail. The Panel considered that the result of these measures is that imported wine is necessarily subject to the listing/delisting procedures of the liquor control board whereas domestic like product can be sold without regard to such requirements. The listing criteria are designed to place certain restrictions on the products which can be sold within the state, including perceived need, quantitative restrictions and expected profitability. The Panel considered that the listing/delisting requirements of these states deny Canadian wine competitive opportunities accorded to United States like products, inconsistent with Article III:4.

5.65 With respect to **Vermont** and **Virginia**, the Panel noted that certain imported wines cannot be sold in state-operated liquor stores whereas the like domestic wine can. The Panel recalled the United States argument that the number of state-operated sales outlets was relatively small compared to the number of private outlets. The Panel considered that although Canadian wine has access to most of the available sales outlets in these states, it is still denied competitive opportunities accorded to domestic like products with respect to sales in state-operated outlets. Therefore, the Panel considered that the Vermont and Virginia measures are inconsistent with Article III:4.

5.66 The Panel further noted that the **New Hampshire** statute requires that wines manufactured or bottled in New Hampshire receive preferential treatment with respect to listing and delisting procedures. The Panel recalled the claim by the United States that this statutory preference for local wines was not enforced. The Panel considered that its previous findings with respect to the non-enforcement of mandatory provisions apply equally with respect to New Hampshire's listing/delisting regulations.

---

[27]Report of the Panel on "Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies", [not yet considered by the Council,] DS17/R, pages 54-55.

[28]Report of the Panel on "Canada - Import, Distribution and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies", [not yet considered by the Council,] DS17/R, page 56.

5.67 With respect to the listing/delisting policies of **Alabama** and **Oregon**, the Panel considered that the evidence submitted by Canada does not support the view that imported product is treated in a manner less favourable than like domestic product.

5.68 The Panel recalled the United States contention that the listing/delisting requirements of **North Carolina** did not apply to wine. The Panel carefully examined the evidence submitted to it. While recognizing the lack of clarity of the North Carolina provisions, and in particular the confusing use of terms, the Panel considered that the evidence does not support the conclusion that wine imported into North Carolina is subject to listing/delisting requirements.

5.69 On the basis of its examination, the Panel found that the listing and delisting practices maintained in the states of **Idaho**, **Mississippi**, **New Hampshire**, **Pennsylvania**, **Vermont** and **Virginia** are inconsistent with Article III:4 because they accord to imported wines, in their offering for sale, treatment less favourable than that accorded to like domestic products.

Beer Alcohol Content Requirements

5.70 The Panel then examined the claim by Canada that restrictions on points of sale, distribution and labelling based on the alcohol content of beer above 3.2 per cent by weight maintained by the states of **Colorado**, **Florida**, **Kansas**, **Minnesota**, **Missouri**, **Oklahoma** and **Utah**, and above 5 per cent by volume in **Alabama** and above 4 per cent by weight in **Oregon**, discriminated against imported beer and contravened Articles III:1 and III:4. The Panel recalled in this regard Canada's argument that all beer, whether containing an alcohol content of above or below the particular level set by these states (hereinafter referred to as "high alcohol beer" and "low alcohol beer", respectively) were like products within the meaning of Article III:4. Canada argued that the 3.2 per cent (or 5 per cent by volume or 4 per cent by weight) level were entirely arbitrary. According to Canada, restrictions as to the location at which high alcohol beer could be sold in the states of **Alabama**, **Colorado**, **Kansas**, **Missouri**, **Oklahoma**, **Oregon** and **Utah**, and differential labelling requirements imposed on such beer in the states of **Florida**, **Kansas**, **Minnesota** and **Oklahoma**, discriminated against imported beer. The Panel further recalled the arguments of the United States that the beer alcohol content measures in the above-named states did not differentiate between imported and domestic beer or otherwise discriminate against imported beer; that low alcohol beer need not be considered a like product to high alcohol beer; that in any case such measures could be justified under Articles XX(a) and (b) as necessary to the protection of human life and health and public morals; and that certain of the state statutes in question were covered by the PPA.

5.71 The Panel began its examination of these beer alcohol content distinctions in the named states by considering whether, in the context of Article III:4, low alcohol beer and high alcohol beer should be considered "like products". The Panel recalled in this regard its earlier statement on like product determinations and considered that, in the context of Article III, it is essential that such determinations be made not only in the light of such criteria as the products' physical characteristics, but also in the light of the purpose of Article III, which is to ensure that internal taxes and regulations "not be applied to imported or domestic products so as to afford protection to domestic production". The purpose of Article III is not to harmonize the internal taxes and regulations of contracting parties, which differ from country to country. In light of these considerations, the Panel was of the view that the particular level at which the distinction between high alcohol and low alcohol beer is made in the various states does not affect its reasonings and findings.

5.72 The Panel recognized that the treatment of imported and domestic products as like products under Article III may have significant implications for the scope of obligations under the General Agreement and for the regulatory autonomy of contracting parties with respect to their internal tax laws and regulations: once products are designated as like products, a regulatory product differentiation, e.g.

for standardization or environmental purposes, becomes inconsistent with Article III even if the regulation is not "applied … so as afford protection to domestic production". In the view of the Panel, therefore, it is imperative that the like product determination in the context of Article III be made in such a way that it not unnecessarily infringe upon the regulatory authority and domestic policy options of contracting parties. The Panel recalled its earlier statement that a like product determination under Article III does not prejudge like product determinations made under other Articles of the General Agreement or in other legislative contexts.

5.73 The Panel recognized that on the basis of their physical characteristics, low alcohol beer and high alcohol beer are similar. It then proceeded to examine whether, in the context of Article III, this differentiation in treatment of low alcohol beer and high alcohol beer is such "as to afford protection to domestic production". The Panel first noted that both Canadian and United States beer manufacturers produce both high and low alcohol content beer. It then noted that the laws and regulations in question in the various states do not differentiate between imported and domestic beer as such, so that where a state law limits the points of sale of high alcohol content beer or maintains different labelling requirements for such beer, that law applies to all high alcohol content beer, regardless of its origin. The burdens resulting from these regulations thus do not fall more heavily on Canadian than on United States producers. The Panel also noted that although the market for the two types of beer overlaps, there is at the same time evidence of a certain degree of market differentiation and specialization: consumers who purchase low alcohol content beer may be unlikely to purchase beer with a higher alcohol content and vice-versa, and manufacturers target these different market segments in their advertising and marketing.

5.74 The Panel then turned to a consideration of the policy goals and legislative background of the laws regulating the alcohol content of beer. In this regard, the Panel recalled the United States argument that states encouraged the consumption of low alcohol beer over beer with a higher alcohol content specifically for the purposes of protecting human life and health and upholding public morals. The Panel also recalled the Canadian position that the legislative background of laws regulating the alcohol content of beer showed that the federal and state legislatures were more concerned with raising tax revenue than with protecting human health and public morals. On the basis of the evidence submitted, the Panel noted that the relevant laws were passed against the background of the Temperance movement in the United States. It noted further that prior to the repeal of the Eighteenth Amendment of the United States Constitution authorizing Prohibition, amendments to the federal Volstead Act -- the Act which implemented the Eighteenth Amendment -- authorized the sale of low alcohol beer, and that the primary focus of the drafters of these amendments may have been the establishment of a brewing industry which could serve as a new source of tax revenue. However, irrespective of whether the policy background to the laws distinguishing alcohol content of beer was the protection of human health and public morals or the promotion of a new source of government revenue, both the statements of the parties and the legislative history suggest that the alcohol content of beer has not been singled out as a means of favouring domestic producers over foreign producers. The Panel recognized that the level at which the state measures distinguished between low and high alcohol content could arguably have been other than 3.2 per cent by weight. Indeed, as the Panel previously noted, Alabama and Oregon make the distinction at slightly different levels. However, there was no evidence submitted to the Panel that the choice of the particular level has the purpose or effect of affording protection to domestic production.

5.75 Thus, for the purposes of its examination under Article III, and in the context of the state legislation at issue in **Alabama**, **Colorado**, **Florida**, **Kansas**, **Minnesota**, **Missouri**, **Oklahoma**, **Oregon** and **Utah**, the Panel considered that low alcohol content beer and high alcohol content beer need not be considered as like products in terms of Article III:4. The Panel again emphasized that this determination is limited to this particular case and is not to be extended to other Articles or other legislative contexts.

5.76 The Panel then proceeded to examine whether the laws and regulations in the above-mentioned states affecting the alcohol content of beer are applied to imported or domestic beer so as to afford protection to domestic production in terms of Article III:1. In this context, the Panel recalled its finding in paragraph 5.74 regarding the alcohol content of beer and concluded that the evidence submitted to it does not indicate that the distinctions made in the various states with respect to the alcohol content of beer are applied so as to favour domestic producers over foreign producers. Accordingly, the Panel found that the restrictions on points of sale, distribution and labelling based on the alcohol content of beer maintained by the states of **Alabama**, **Colorado**, **Florida**, **Kansas**, **Minnesota**, **Missouri**, **Oklahoma**, **Oregon** and **Utah** are not inconsistent with Article III:1.

5.77 Having found that the two varieties of beer need not be considered as like products in terms of Article III:4 and the specific legislative contexts in the above-mentioned states, and that these laws and regulations affecting the alcohol content of beer are not applied to imported or domestic products so as to afford protection to domestic production in terms of Article III:1, the Panel considered that it need not examine the additional arguments of the parties in respect of the above-mentioned state requirements based on the alcohol content of beer.

Article XXIV:12

5.78 The Panel recalled that the United States invoked Article XXIV:12 in respect of any state measures that the Panel were to find to be inconsistent with the General Agreement. Article XXIV:12 provides:

> "Each contracting party shall take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments and authorities within its territory".

The Panel noted that the United States had not provided the Panel with any evidence in support of its invocation of this provision. In particular, it had presented no evidence in support of its claim that reasonable measures were not available to it to ensure the observance by the state authorities of the relevant provisions of the General Agreement.

5.79 The Panel noted from the drafting history of Article XXIV:12[29] that this provision was designed to apply only to those measures by regional or local governments or authorities which the central government cannot control because they fall outside its jurisdiction under the constitutional distribution of powers. The Panel agreed with this interpretation in view of the general principle of international treaty law that a party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty obligation.[30] As indicated in an earlier panel report[31], not yet adopted by the CONTRACTING PARTIES, the qualification in Article XXIV:12 of the obligation to implement the provisions of the General Agreement grants a special right to federal states without giving an offsetting privilege to unitary states, and has to be construed narrowly so as to avoid undue imbalances in rights and obligations between contracting parties with unitary and federal constitutions. The above-mentioned interpretation -- according to which Article XXIV:12 applies only to measures by regional or local authorities which the central government cannot control under the constitutional distribution of powers -- meets the constitutional difficulties which central governments may have in ensuring the observance of the provisions of the General Agreement by regional and local authorities, but minimizes the risk that such difficulties lead to imbalances in the rights and obligations of contracting parties.

---

[29]See, for example, EPCT/13, page 1; EPCT/C.II/27, page 1; EPCT/C.II/54, page 4; EPCT/C.II/64, page 3.

[30]See, for example, Article 27 of the 1969 Vienna Convention on the Law of Treaties.

[31]Report of the Panel on "Canada - Measures Affecting the Sale of Gold Coins", L/5863, issued 17 September 1983.

5.80 The Panel recalled its finding with respect to the PPA that, according to the evidence submitted to this Panel, GATT law is part of federal law in the United States and as such is superior to GATT-inconsistent state law.[32] Based on the evidence submitted, the Panel concluded that the United States has not demonstrated to the Panel that the general obligation of contracting parties to withdraw measures inconsistent with the General Agreement cannot be observed in this case by the United States as a result of its federal constitutional structure and that the conditions for the application of Article XXIV:12 are met.

6. CONCLUSIONS

6.1 On the basis of the findings set out above, the Panel concluded that:

(a) the provision of a lower rate of federal excise tax on domestic beer from qualifying United States producers, which lower rate is not available in the case of imported beer, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(b) the provision of a federal excise tax credit on domestic wine and cider, which credit is not available to imported wine and cider, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(c) the provision by the states of New York, Oregon, Rhode Island and the Commonwealth of Puerto Rico of excise tax exemptions and reductions to domestic beer and wine, which exemptions and reductions are not available to imported beer and wine, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(d) the provision by the states of Kentucky, Minnesota, Ohio and Wisconsin of excise tax credits to domestic breweries based on annual beer production, which credits are not available to imported beer, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(e) the provision by the states of Alabama, Georgia, Nebraska and New Mexico of lower excise tax rates on wine based upon its in-state or domestic origin, which lower rates are not available to imported wine, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(f) the application by the state of Iowa of an excise tax at the wholesale level, which applies to all imported wine but not necessarily to all domestic wine which -- unlike imported wine, -- may be sold directly at retail, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(g) the provision by the states of Michigan, Ohio and Rhode Island of preferential excise tax treatment to wine produced from local ingredients is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(h) the provision by the state of Mississippi of a lower excise tax rate to wine produced from a special variety of grape with a limited growing area, which rate is not available to imported wine produced from other varieties of grape, is inconsistent with Article III:2, first sentence;

---

[32]The Panel noted that this view is also shared by the legal authorities to which the parties referred in their submissions. E.g. Hudec, "The Legal Status of GATT in the Domestic Law of the United States" in Hilf, Jacobs, Petersmann (eds), the European Community and GATT (1986), page 221: "Article XXIV:12 obligates the United States to compel state adherence to [the General Agreement] …".

(i) the provision by the state of Pennsylvania of an excise tax credit on beer for the purchase of manufacturing equipment, which credit is not available to imported beer, is inconsistent with Article III:2, first sentence, and is not covered by Article III:8(b);

(j) the exemption by the states of Alaska (beer and wine), California (beer and wine), Connecticut (beer and wine), Florida (beer and wine), Hawaii (beer and wine), Idaho (beer), Illinois (beer, whether or not the exemption is currently being given effect), Indiana (beer and wine), Iowa (beer and wine), Kansas (beer and wine), Louisiana (beer and wine), Maine (beer and wine), Maryland (beer and wine), Massachusetts (beer and wine), Minnesota (beer and wine), Montana (beer), New Hampshire (beer and wine), Ohio (beer and wine), Oregon (beer and wine), Pennsylvania (beer and wine), Rhode Island (beer and wine), Tennessee (beer), Texas (beer and wine), Utah (beer containing not more than 3.2 per cent alcohol by weight), Virginia (beer), Washington (beer and wine), West Virginia (wine) and Wisconsin (beer and wine) of local producers from state requirements to use wholesalers, which requirements apply in the case of imported beer and wine, is inconsistent with Article III:4 and has not been demonstrated to be justified under Article XX(d);

(k) the record does not support findings that the distribution requirements in Kentucky and Missouri are inconsistent with Article III:4;

(l) the requirements in the states of Arizona, California, Maine, Mississippi and South Carolina that imported beer and wine be transported into these states by common carrier, which requirements do not exist for the in-state like products, are inconsistent with Article III:4 and have not been demonstrated to be justified under Article XX(d).

(m) the application of a higher licensing fee for imported beer and/or wine in the states of Alaska (beer and wine) and Vermont (beer only) than for the like domestic products is, in the case of Alaska, in view of the wholesaler requirement applicable to imported beer and wine, inconsistent with Article III:4, and, in the case of Vermont, inconsistent with Article III:2, first sentence;

(n) the exemption by the state of Mississippi of domestic in-state wine, but not the like imported product, from decisions to prohibit the sale of alcohol within political subdivisions of the state is inconsistent with Article III:4, whether or not the law is presently being implemented;

(o) the application by the states of Massachusetts and Rhode Island of price affirmation requirements for imported beer and wine, which requirements are not applicable to the like domestic products, is inconsistent with Article III:4, whether or not these requirements are presently being enforced;

(p) the listing and delisting practices maintained by the liquor control boards in the states of Idaho, Mississippi, New Hampshire, Pennsylvania, Vermont and Virginia, which accord to imported wine less favourable treatment than that accorded to the like domestic product, are inconsistent with Article III:4;

(q) the record does not support a finding that the listing and delisting practices in the states of Alabama, North Carolina and Oregon are inconsistent with Article III:4;

(r) the beer alcohol content requirements maintained in the states of Alabama, Colorado, Florida, Kansas, Minnesota, Missouri, Oklahoma, Oregon and Utah are not inconsistent with either Article III:4 or Article III:1;

(s) the record does not support a finding that the state wholesaler distribution requirements in Connecticut, Florida, Maryland, Massachusetts, Missouri, Oregon, Texas and Utah are "mandatory existing legislation" in terms of the Protocol of Provisional Application;

(t) the United States has not demonstrated to the Panel that the conditions for the application of Article XXIV:12 have been met; and

(u) in view of the Panel's conclusions in respect of federal and state tax measures, it is not necessary to address Canada's subsidiary argument that these federal and state tax measures nullify or impair tariff concessions on beer, wine and cider granted by the United States pursuant to Article II.

6.2 The Panel recommends that the CONTRACTING PARTIES request the United States to bring its inconsistent federal and state measures into conformity with its obligations under the General Agreement.