

NORTH AMERICAN FREE TRADE AGREEMENT

ARBITRAL PANEL ESTABLISHED PURSUANT TO ARTICLE 2008

**IN THE MATTER OF**

**TARIFFS APPLIED BY CANADA TO  
CERTAIN U.S.-ORIGIN AGRICULTURAL PRODUCTS**

*(Secretariat File No. CDA-95-2008-01)*

Final Report of the Panel

December 2, 1996

Panel Members

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Professor Ronald C.C. Cuming, Q.C.  
Professor Donald M. McRae  
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## I. INTRODUCTION

1. On February 2, 1995, the United States requested consultations with Canada pursuant to Article 2006(4) of the *North American Free Trade Agreement* ("NAFTA") "concerning the Government of Canada's application of customs duties higher than those specified in the NAFTA to certain agricultural goods that are originating goods within the meaning of the NAFTA". The consultations failed to resolve the matter. On June 1, 1995, the United States Trade Representative ("USTR") requested a meeting of the Free Trade Commission pursuant to NAFTA Article 2007. The Commission was unable to resolve the matter.

2. On July 14, 1995, the USTR requested the establishment of an arbitral panel pursuant to NAFTA Article 2008. By a letter of July 19, 1995, the Government of Mexico, acting under NAFTA Article 2013, expressed its intention to participate in the proceedings as a third party.

3. The Panel was constituted with the appointment, on January 19, 1996, of Professor Elihu Lauterpacht as Chair. The other members of the Panel were Professors Ronald C.C. Cuming, Donald M. McRae and Sidney Picker, Jr., and Dean Stephen Zamora.<sup>1</sup>

4. In accordance with the *Model Rules of Procedure for Chapter Twenty*<sup>2</sup> ("the Model Rules"), as supplemented by the instructions of the disputing Parties communicated by a letter of January 19, 1996, the following schedule applied:

January 22, 1996	-	United States to file its initial written submission
February 19, 1996	-	Canada to file its written counter-submission
	-	Mexico to file its initial written submission
March 12, 1996	-	hearing
within 10 days of hearing	-	participating Parties to file supplementary written

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<sup>1</sup> The following were appointed as Assistants to the Panelists: Daniel Bethlehem and Emanuela Gillard (Professor Lauterpacht), Yair Baranes (Professor Cuming), Christopher J. Kent, until August 30, 1996 (Professor McRae), Colin B. Picker (Professor Picker) and Craig L. Jackson (Dean Zamora).

<sup>2</sup> *Model Rules of Procedure for Chapter Twenty of the North American Free Trade Agreement and Supplementary Procedures Pursuant to Rule 35 on the Availability of Information*, July 13, 1995.

- submissions
- May 9, 1996 - initial report of the Panel to be presented to the disputing Parties
- May 23, 1996 - disputing Parties entitled to submit comments on the initial report
- June 10, 1996 - final report of the Panel to be presented to the disputing Parties

5. The First Submission of the United States was filed on January 22, 1996. The Counter-Submission of Canada and the First Submission of Mexico were filed on February 19, 1996.

6. The hearing was held in Ottawa on March 12-13, 1996. Subsequent to the hearing, the Panel submitted additional questions to the participating Parties. Following consultations between the Panel and the disputing Parties pursuant to Rule 20 of the Model Rules, the Panel modified the post-hearing schedule as follows:

- March 22, 1996 - the participating Parties to exchange, and provide to the Panel, copies of documents referred to at the hearing
- April 12, 1996 - supplementary written submissions to be filed
- July 15, 1996 - initial report of the Panel to be presented to the disputing Parties
- July 29, 1996 - disputing Parties entitled to submit comments on the initial report
- August 15, 1996 - final report of the Panel to be presented to the disputing Parties

7. In accordance with the revised schedule, on March 22, 1996 the disputing Parties provided the Panel with the documents referred to at the hearing. The supplementary written submissions of the participating Parties were filed on April 12, 1996. The Initial Report of the Panel was submitted to the disputing Parties on July 15, 1996. The disputing Parties submitted comments on the Initial Report to the Panel on July 29, 1996.

8. In light of the comments submitted on the Initial Report, the Panel, in accordance with NAFTA Article 2016(5), requested the views of Canada on one matter. Following an application by the United States, the Panel

permitted the United States an opportunity to comment in writing on the Canadian response to the Panel's enquiry and Canada an opportunity to reply to these further United States comments. The fact of these exchanges meant that the Panel was not in a position to present its Final Report to the disputing Parties on August 15, 1996 as previously determined. As a result, and in accordance with NAFTA Article 2017(1) and Rule 20 of the Model Rules, the Panel consulted the disputing Parties for the purpose of obtaining their agreement to an extension of the period within which the Final Report was to be presented to them. The disputing Parties agreed to the extension of time proposed by the Panel. The Final Report is presented to the disputing Parties in accordance with this revised schedule.

## II. SUBJECT-MATTER OF THE DISPUTE

9. In its First Submission, the United States identifies the subject-matter of the dispute as

the duties being applied by the Government of Canada ... to certain agricultural goods (generally dairy, poultry, eggs, barley and margarine, including products thereof) that are originating goods as defined in the North American Free Trade Agreement ...

10. The goods in issue are specified in detail by reference to the relevant *Harmonized Commodity Description and Coding System*<sup>3</sup> number in the enclosure to a letter of July 10, 1995 from the USTR to the Canadian Minister of International Trade. The goods therein specified include poultry (chicken and turkey) and poultry products, dairy and dairy products (including milk, yogurt, buttermilk, whey, butter and other milk fats and oils, cheeses, curd, ice cream and other preparations containing milk and milk products), eggs and egg products, margarine, and barley and barley products.

11. The United States contends that Canada is applying, in respect of over-quota imports of these goods from the United States, tariffs<sup>4</sup> which are in excess of those agreed to by Canada under the NAFTA. The United States alleges that Canada increased its tariffs on some of the goods in question on January 1, 1995 and on the remainder of the goods on August 1, 1995 contrary to its NAFTA undertakings. The United States asserts that

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<sup>3</sup> Commonly referred to simply as the Harmonized System or HS.

<sup>4</sup> The word "tariff" is used in this Report by the Panel in preference to the word "duty" or "customs duty" for reasons of consistency only. In their submissions to the Panel, the participating Parties variously referred to the Canadian measures in issue in these proceedings as "tariffs", "tariff-rate quotas", "tariff equivalents", "duties" and "customs duties". For the purpose of this Report, the Panel understands the term "tariff" to mean simply a charge levied on the import of a product.

under the NAFTA

... Canada committed not to increase the rates of duties on the goods at issue above the rates in effect on December 31, 1993, and progressively to eliminate the duties on these goods ...<sup>5</sup>

12. Additionally, the United States contends that, under the NAFTA, the goods in issue "are to be assessed import duties at a special, concessionary rate".<sup>6</sup>

13. Canada does not dispute the fact of its imposition of tariffs in respect of over-quota imports of certain U.S.-origin goods in the period from January 1, 1995. However, whereas the United States characterizes the Canadian action as an *increase* in tariffs contrary to the NAFTA, Canada acknowledges only that it "has established TRQs [tariff-rate quotas]<sup>7</sup> for the agricultural products in question".<sup>8</sup> Canada maintains that it was required to establish these tariffs in respect of the goods in issue by the *Agreement on Agriculture* concluded in the context of the *Marrakesh Agreement Establishing the World Trade Organization* ("WTO Agreement").

### III. TERMS OF REFERENCE

14. By a letter jointly signed by their representatives on September 21, 1995, the disputing Parties agreed on the following terms of reference for the Panel in accordance with Rule 4 of the Model Rules and NAFTA Article 2012:

To examine, in the light of the relevant provisions of the North American Free Trade Agreement, the application of customs duties by the Government of Canada to the U.S.-origin products specified in the enclosure to the July 10, 1995, letter of the United States Trade Representative Michael Kantor to the Canadian Minister for International Trade Roy MacLaren, and to make findings and determinations as provided in Article 2016(2)(a) and (b).

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<sup>5</sup> First Submission of the United States, at para.3.

<sup>6</sup> First Submission of the United States, at para.1.

<sup>7</sup> Canada describes a tariff-rate quota as consisting of "a low tariff rate for a negotiated quantity of imports for a product ("in-quota"), and a higher tariff rate on the quantities in excess ("over-quota)" (Counter-Submission of Canada, at p.i). A similar definition is given in the First Submission of the United States (at para.12, note 2).

<sup>8</sup> Counter-Submission of Canada, at para.16.

15. The terms of reference do not request the Panel to make recommendations for the resolution of the dispute. Nor has the Panel been asked to determine whether the measures in contention have caused nullification or impairment of benefits accruing under any provision of the NAFTA.

#### **IV. CENTRAL CONTENTIONS OF THE DISPUTING PARTIES**

##### **A. The United States**

16. The central contention of the United States is that Canada is applying tariffs to over-quota imports of specified agricultural products of U.S.-origin contrary to its commitments under the NAFTA. In the submission of the United States, these over-quota tariff rates are "significantly in excess of the NAFTA bound rate of duty and significantly above the rate in existence on December 31, 1993".<sup>9</sup>

17. The United States invokes NAFTA Article 302(1) and (2) which provide:

1. Except as otherwise provided in this Agreement, no Party may increase any existing customs duty, or adopt any customs duty, on an originating good.

2. Except as otherwise provided in this Agreement, each Party shall progressively eliminate its customs duties on originating goods in accordance with its Schedule to Annex 302.2.

18. As existing customs duties were those which, pursuant to NAFTA Article 201(1), were "in effect on the date of entry into force of this Agreement", any increase in tariffs above the rate in effect on December 31, 1993 - the day preceding the entry into force of the NAFTA on January 1, 1994 - constitutes a breach of NAFTA Article 302(1).

##### **B. Canada**

19. Canada contends that, while it imposed tariffs on over-quota imports of specified U.S.-origin goods in

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<sup>9</sup> First Submission of the United States, at para.12.



the period in question, the tariffs were imposed in consequence of an obligation to tariffy<sup>10</sup> existing non-tariff barriers to trade in the goods in question pursuant to the *WTO Agreement on Agriculture*. This agreement entered into force as between Canada and the United States on January 1, 1995. The tariffs applied to over-quota imports of U.S.-origin goods are therefore measures equivalent in protective effect to the non-tariff barriers that had been applied to the U.S.-origin goods prior to the period in question rather than new restrictions on imports.

20. Canada further contends that, under the NAFTA, the disputing Parties agreed that while in-quota trade in agricultural goods between them would continue to be governed by the regime established by the *Canada-United States Free Trade Agreement* ("FTA"), over-quota trade would be governed by the arrangements that would emerge from the *Uruguay Round of Multilateral Trade Negotiations* ("Uruguay Round"). As the tariffs were imposed pursuant to the *WTO Agreement on Agriculture* obligation to convert existing non-tariff barriers into tariff equivalents, their application to the trade in agricultural goods between Canada and the United States is consistent with the Parties' commitments under the NAFTA.

21. Canada relies, *inter alia*, on FTA Article 710, incorporated into the NAFTA by NAFTA Annex 702.1, on NAFTA Article 309(1) and/or on NAFTA Note 5 as well as on the *travaux préparatoires* and other documents and on the subsequent practice of the disputing Parties.

## V. FACTUAL AND LEGAL BACKGROUND

### A. The *Canada-United States Free Trade Agreement* (FTA)

22. In May-June 1986, Canada and the United States began negotiations towards the conclusion of a free trade agreement. The FTA was signed on January 2, 1988 and entered into force on January 1, 1989.

23. In respect of trade in goods, the Parties set out a number of general obligations in FTA Chapter Four. By FTA Article 401(1), Canada and the United States agreed that neither Party would increase existing, or

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<sup>10</sup> Tariffication refers to the process of converting non-tariff barriers into tariff equivalents, that is, a tariff rate which provides a level of protection which is equivalent to that provided by the non-tariff barrier. As pointed out later in this Report, the actual practice of tariffication was not always consistent with this definition.

introduce new, customs duties on originating goods, save as provided in the Agreement. By FTA Article 401(2), the Parties established a three-stage regime for the progressive elimination of tariffs on originating goods.<sup>11</sup>

24. In respect of trade in agricultural goods, the Parties set out particular arrangements in FTA Chapter Seven. Specific arrangements were adopted in respect of trade in fresh fruits and vegetables (FTA Article 702), market access for meat (FTA Article 704), market access for grain and grain products (FTA Article 705), market access for poultry and eggs (FTA Article 706) and market access for sugar-containing products (FTA Article 707).<sup>12</sup>

25. Although the Parties agreed to prohibit, subject to exceptions, the imposition of quantitative restrictions in respect of the import of some goods (notably meat), market access for grain, grain products, poultry and eggs was governed by specific arrangements which contemplated some restrictions on imports.

26. FTA Article 710 provided:

Unless otherwise specifically provided in this Chapter, the Parties retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the *General Agreement on Tariffs and Trade* (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI.

27. The disputing Parties accept that FTA Article 710 was intended to preserve their rights under GATT Article XI, the *Protocol of Provisional Application* of the GATT ("GATT PPA") and waivers granted by decision of the CONTRACTING PARTIES under GATT Article XXV:5 ("GATT waivers"). In particular, Canada was concerned to ensure, *inter alia*, that its domestic supply management regime in respect of certain dairy, poultry and egg products, imposed in reliance on GATT Article XI:2(c)(i),<sup>13</sup> could be maintained. Canada

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<sup>11</sup> In accordance with FTA Article 201(1), originating goods meant goods qualifying under the rules of origin set out in FTA Chapter Three.

<sup>12</sup> Other substantive provisions addressed agricultural subsidies (FTA Article 701) and technical regulations and standards for agricultural, food, beverage and certain related goods (FTA Article 708).

<sup>13</sup> GATT Article XI:2(c)(i) provides:

2. The provisions of paragraph 1 of this Article [requiring the general elimination of quantitative restrictions] shall not extend to the following:

...

also relied upon paragraph 1(b) of the GATT PPA to permit it to maintain restrictions on the import of margarine.<sup>14</sup> The United States was concerned to ensure acceptance under the FTA of the 1955 waiver granted to it pursuant to GATT Article XXV:5.<sup>15</sup>

## **B. The GATT Uruguay Round and the conclusion of the *North American Free Trade Agreement***

28. Shortly after the commencement of the FTA negotiations, the Uruguay Round was launched with the *Punta del Este Declaration* of September 20, 1986.<sup>16</sup> By that Declaration, the CONTRACTING PARTIES decided "to enter into Multilateral Trade Negotiations on trade in goods within the framework and under the aegis of the General Agreement on Tariffs and Trade".

29. Various Contracting Parties, including Canada and the United States, submitted proposals suggesting approaches to the negotiations. On July 7, 1987 the United States presented its first proposal on agricultural reform calling for a complete phase-out over 10 years of all import barriers.<sup>17</sup> This was followed by a further proposal by the United States on November 9, 1988 in which it was suggested that all non-tariff barriers to imports be converted into tariff equivalents.<sup>18</sup> The tariffication proposal was developed further in a series of documents submitted by the United States - in particular, a *Discussion Paper on Tariffication* of July 10, 1989 ("the July 1989 U.S. Tariffication Paper") and a *Submission on Comprehensive Long-Term Agricultural Reform*

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- (c) Import restrictions on any agricultural or fisheries product, imported in any form, necessary to the enforcement of governmental measures which operate:
    - (i) to restrict the quantities of the like domestic product permitted to be marketed or produced, or, if there is no substantial domestic production of the like product, of a domestic product for which the imported product can be directly substituted; ...

<sup>14</sup> Paragraph 1(b) of the PPA, the so-called "grandfather clause", provides that the Contracting Parties undertake to apply provisionally Part II of the GATT, including GATT Article XI requiring the general elimination of quantitative restrictions, "to the fullest extent not inconsistent with existing legislation". In its submissions to the Panel, Canada indicated that it had maintained a prohibition on the importation of margarine "since at least 1885" (Annex B to the Counter-Submission of Canada, at para.179).

<sup>15</sup> The waiver in question is the *Waiver Granted to the United States in Connection with Import Restrictions Imposed under Section 22 of the United States Agricultural Adjustment Act (of 1933), as Amended* by decision of the CONTRACTING PARTIES of March 5, 1955; BISD 3S/32.

<sup>16</sup> BISD 33S/19.

<sup>17</sup> GATT Document MTN.GNG/NG5/W/14.

<sup>18</sup> GATT Document MTN.GNG/NG5/W/83.

of October 25, 1989.<sup>19</sup>

30. In contrast to the United States tariffication proposal, Canada submitted proposals aimed at "strengthening and clarifying" the application of GATT Article XI.<sup>20</sup>

31. In the midst of these multilateral trade negotiations, in June 1991, Canada, Mexico and the United States began negotiations towards the conclusion of a North American free trade agreement. The NAFTA was signed on December 17, 1992 and entered into force on January 1, 1994.

32. Overlapping with the NAFTA negotiations, the Uruguay Round negotiations continued until December 15, 1993. The Agreement establishing the WTO, including the Uruguay Round package of agreements of which the *WTO Agreement on Agriculture* was a part, was signed on April 15, 1994 and entered into force on January 1, 1995.

33. The timeline of the various negotiations in which the disputing Parties were engaged was thus as follows:

May-June 1986	-	FTA negotiations begin
September 1986	-	Uruguay Round negotiations begin
January 2, 1988	-	FTA signed
January 1, 1989	-	FTA enters into force
June 1991	-	NAFTA negotiations begin
December 17, 1992	-	NAFTA signed
December 15, 1993	-	Uruguay Round negotiations conclude
January 1, 1994	-	NAFTA enters into force
April 15, 1994	-	Agreement establishing the WTO signed
January 1, 1995	-	WTO Agreement enters into force

34. As is thus evident, the disputing Parties were pursuing negotiations on trade in agricultural goods in two

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<sup>19</sup> Respectively, GATT Document MTN.GNG/NG5/W/97, July 10, 1989 and GATT Document MTN.GNG/NG5/W/118, October 25, 1989.

<sup>20</sup> See, for example, the Canadian proposal of March 14, 1990; GATT Document MTN.GNG/NG5/W/159.

different contexts at the same time - multilaterally, within the Uruguay Round, and bilaterally or trilaterally within the framework of the NAFTA. Within the Uruguay Round, the Parties, together with other participating states,<sup>21</sup> were addressing various proposals, including that of the United States, in favour of the comprehensive tariffication of all existing non-tariff barriers to agricultural trade, and that of Canada, in favour of strengthening and clarifying GATT Article XI.

35. From at latest December 1991 it appears that the momentum in favour of tariffication within the Uruguay Round was such that the proposal was likely to be adopted. This is evident from the *Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations* - Section L of which contained a "Text on Agriculture" - circulated on December 20, 1991 by the Chairman of the Trade Negotiations Committee, Arthur Dunkel ("the Dunkel Draft").<sup>22</sup>

36. Part B of the Dunkel Draft "Text on Agriculture" was subsequently distributed in amended form as a separate document by the Chairman of the Market Access Group on December 20, 1993 under the title *Modalities for the Establishment of Specific Binding Commitments under the Reform Programme* ("the Modalities Document").<sup>23</sup> Paragraph 4 of the Modalities Document provided:

4. For agricultural products currently subject to border measures other than ordinary customs duties, the reduction commitment specified in paragraph 5 below shall be implemented on customs duties resulting from the conversion of such measures ("tariffication"). The modalities of the conversion and other related provisions, including those relating to current access opportunities, and the establishment of minimum access opportunities are set out in Annex 3. The special safeguard provision may be invoked only in respect of these tariffied products.

37. Annex 3 of the Modalities Document went on to provide, in paragraph 3, that

[t]ariff equivalents shall be established for all agricultural products subject to border measures other than ordinary customs duties ...

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<sup>21</sup> In this Report, the term "states" is used generically to describe GATT contracting parties, participants in the Uruguay Round negotiations and WTO Members.

<sup>22</sup> GATT Document MTN.TNC/W/FA.

<sup>23</sup> GATT Document MTN.GNG/MA/W/24.

### **C. The WTO Agreement on Agriculture**

38. The Uruguay Round came to an end with the adoption and signature of the *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations* ("the Final Act") in Marrakesh on April 15, 1994. The WTO Agreement, including the *WTO Agreement on Agriculture*, was an integral part of the Final Act. In accordance with the terms of paragraph 4 of the Final Act, the WTO Agreement entered into force on January 1, 1995.

39. Article 4 of the *WTO Agreement on Agriculture*, under the heading "Market Access", provides as follows:

1. Market access concessions contained in Schedules relate to bindings and reductions of tariffs, and to other market access commitments as specified therein.

2. Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties<sup>1</sup>, except as otherwise provided for in Article 5 and Annex 5.

<sup>1</sup> These measures include quantitative import restrictions, variable import levies, minimum import prices, discretionary import licensing, non-tariff measures maintained through state-trading enterprises, voluntary export restraints, and similar border measures other than ordinary customs duties, whether or not the measures are maintained under country-specific derogations from the provisions of GATT 1947, but not measures maintained under balance-of-payments provisions or under other general, non-agriculture-specific provisions of GATT 1994 or of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement.<sup>24</sup>

### **D. Relevant NAFTA provisions**

40. The substantive provisions of the NAFTA relevant to the present dispute are found in Chapters Three and Seven, both of which are situated in Part Two of the NAFTA dealing with trade in goods. Chapter Three addresses the issue of "National Treatment and Market Access for Goods". Chapter Seven, in Section A, lays down measures relating to agricultural trade.

41. NAFTA Article 300, addressing the scope and coverage of Chapter Three, provides, *inter alia*, as follows:

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<sup>24</sup> Article 5 of the *WTO Agreement on Agriculture* addresses the application of "special safeguard provisions" "... in connection with the importation of an agricultural product, in respect of which measures referred to in paragraph 2 of Article 4 of this Agreement have been converted into an ordinary customs duty ..."

This Chapter applies to trade in goods of a Party, including:

...

(c) goods covered by another Chapter in this Part, except as provided in such ... Chapter.

42. NAFTA Article 302, in paragraphs (1) and (2),<sup>25</sup> provides, *inter alia*, that, insofar as originating goods are concerned, and except as otherwise provided in the NAFTA, no Party may increase any existing customs duty, or adopt any customs duty and that each Party shall progressively eliminate its customs duties in accordance with its Schedule to NAFTA Annex 302.2.

43. Under the heading "Non-Tariff Measures", NAFTA Article 309(1) addresses the issue of import and export restrictions in the following terms:

1. Except as otherwise provided in this Agreement, no Party may adopt or maintain any prohibition or restriction on the importation of any good of another Party or on the exportation or sale for export of any good destined for the territory of another Party, except in accordance with Article XI of the GATT, including its interpretative notes, and to this end Article XI of the GATT and its interpretative notes, or any equivalent provision of a successor agreement to which all Parties are party, are incorporated and made a part of this Agreement.

44. NAFTA Article 701, addressing the scope and coverage of NAFTA Chapter Seven, "Section A - Agriculture", provides as follows:

#### **Article 701: Scope and Coverage**

1. This Section applies to measures adopted or maintained by a Party relating to agricultural trade.

2. In the event of any inconsistency between this Section and another provision of this Agreement, this Section shall prevail to the extent of the inconsistency.

45. In respect of agricultural trade, whereas Mexico and the United States, and Canada and Mexico, agreed bilaterally to the tariffication of non-tariff barriers to agricultural trade under the NAFTA, Canada and the United States were unable to reach such an agreement.

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<sup>25</sup> See paragraph 17 *supra*.

46. The failure of the three negotiating states to agree on a comprehensive trilateral regime for trade in agriculture under the NAFTA led ultimately to the conclusion of three separate bilateral arrangements on agriculture brought together under the framework of NAFTA Chapter Seven. As regards Mexico and the United States, trade in agriculture was addressed in NAFTA Article 703(2) and Annex 703.2, Section A. As regards Canada and Mexico, trade in agricultural goods was addressed in NAFTA Article 703(2) and Annex 703.2, Section B.

47. The regime applicable to agricultural trade between Canada and the United States was addressed in NAFTA Article 702(1) and Annex 702.1 in the following terms:

**Article 702: International Obligations**

1. Annex 702.1 applies to the Parties specified in that Annex with respect to agricultural trade under certain agreements between them.

...

**Annex 702.1**

**Incorporation of Trade Provisions**

1. Articles 701, 702, 704, 705, 706, 707, 710 and 711 of the *Canada - United States Free Trade Agreement*, which Articles are hereby incorporated into and made part of this Agreement, apply as between Canada and the United States.

2. The definitions of the terms specified in Article 711 of the *Canada - United States Free Trade Agreement* shall apply to the Articles incorporated by paragraph 1.

3. For purposes of this incorporation, any reference to Chapter Eighteen of the *Canada - United States Free Trade Agreement* shall be deemed to be a reference to Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures) of this Agreement.

4. The Parties understand that Article 710 of the *Canada - United States Free Trade Agreement* incorporates the GATT rights and obligations of Canada and the United States with respect to agricultural, food, beverage and certain related goods, including exemptions by virtue of paragraph 1(b) of the Protocol of Provisional Application of the GATT and waivers granted under Article XXV of the GATT.

48. There is no dispute between the Parties that the goods in issue in these proceedings come within the scope of both NAFTA Chapter Seven and the *WTO Agreement on Agriculture*.



## VI. ARGUMENTS OF THE PARTIES

### A. The United States position and the Parties' characterization of the dispute

49. The central contention of the United States is that Canada has imposed tariffs on over-quota imports of specified U.S.-origin agricultural goods beyond the rates that applied on December 31, 1993. This imposition of tariffs amounts to an increase in tariffs contrary to NAFTA Article 302(1).<sup>26</sup> This increase in tariffs also constitutes a breach of the undertaking of the Parties in NAFTA Article 302(2) progressively to eliminate tariffs on originating goods. The United States also points to NAFTA Annex 302.2(8), noting that "[t]his is a complicated way of saying that Canada (like the United States) agreed in the NAFTA to carry forward its FTA tariff phase-out for imports of agricultural goods produced in the other country's territory".<sup>27</sup>

50. Focusing on the language of NAFTA Article 302(1) and (2) - "[e]xcept as otherwise provided in this Agreement" - and on Rule 34 of the Model Rules,<sup>28</sup> the United States further contends "that the burden is on the Government of Canada to demonstrate that Canada's tariffs are excused by an exception in the NAFTA".<sup>29</sup>

51. Canada takes issue with this characterization of the dispute by the United States. In Canada's contention,

this dispute is not just about the fact Canada has imposed new customs duties or their rates. We say it is more fundamentally about a negotiated market access and the interaction between Chapters Three and Seven of the NAFTA. Canada and the United States have never come to a bilateral agreement on the terms of market access for the over-quota goods under dispute ...<sup>30</sup>

52. The Canadian submissions emphasize the nature of the "deal" that was concluded in respect of trade in agricultural goods under the NAFTA:

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<sup>26</sup> See paragraph 17 *supra*.

<sup>27</sup> First Submission of the United States, para.14, note 6.

<sup>28</sup> Rule 34: "A Party asserting that a measure is subject to an exception under the Agreement shall have the burden of establishing that the exception applies."

<sup>29</sup> Oral Submission of the United States, Transcript, at p.18.

<sup>30</sup> Oral Submission of Canada, Transcript, at p.88.

The essential principle underlying the agricultural "deal" for these goods in the FTA, carried forward through explicit incorporation into the NAFTA, was preferential market access for in-quota imports, coupled with an agreement to apply the multilateral regime to over-quota imports.<sup>31</sup>

53. The "deal" was thus, in Canada's contention, "fundamentally about market access and not about establishing 'rules' from which 'the level of trade follows'".<sup>32</sup> "There is no dispute", in Canada's submission, "that under the FTA and then the NAFTA, Canada and the United States were entitled to limit market access for certain agricultural goods through quantitative restrictions".<sup>33</sup>

54. On the question of the burden of proof, Canada, pointing to Rule 33 of the Model Rules,<sup>34</sup> contends that "[a]s complainant, the United States bears the burden of proving its complaint".<sup>35</sup>

## **B. Canada's substantive defence**

55. On the substance of the United States contention, Canada argues that, although it had imposed tariffs on over-quota imports of certain U.S.-origin agricultural goods in the period after December 31, 1993, it did so pursuant to an obligation to tariffify non-tariff barriers. The Parties had agreed within the NAFTA that over-quota trade in agricultural goods between Canada and the United States would be governed by the arrangements that would emerge from the Uruguay Round negotiations. Consequently, the obligation to tariffify existing non-tariff barriers pursuant to the *WTO Agreement on Agriculture*, and the application of these tariff equivalents to the trade in agricultural goods between Canada and the United States, was consistent with Canada's commitments under the NAFTA.

56. Canada also points out that,

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<sup>31</sup> Second Submission of Canada, at para.7.

<sup>32</sup> Second Submission of Canada, at para.8.

<sup>33</sup> Counter-Submission of Canada, at para.22.

<sup>34</sup> Rule 33: "A Party asserting that a measure of another Party is inconsistent with the provisions of the Agreement shall have the burden of establishing such inconsistency."

<sup>35</sup> Counter-Submission of Canada, at para.20.

[b]ecause these tariff equivalents are merely conversions of previous non-tariff measures, they are not new or additional restrictions on U.S. access to the Canadian agricultural market. The result of the *WTO Agreement on Agriculture* is that the United States has *not* lost any access to the Canadian agricultural market; either it enjoys the access it already had or it enjoys enhanced access.<sup>36</sup>

57. Canada also draws attention to the fact that the United States, while challenging the legitimacy under the NAFTA of certain Canadian tariffs on over-quota agricultural imports, is applying "exactly the same type of measure as it impugns on over-quota quantities of certain Canadian agricultural products".<sup>37</sup>

58. Canada's defence to the United States allegations thus rests on two central, substantive propositions and two ancillary propositions. On the substance, Canada contends: (a) that it was obliged, under the *WTO Agreement on Agriculture*, to tariffify its existing non-tariff barriers to agricultural imports, and (b) that it is entitled under the NAFTA to apply the tariffs thereby created to over-quota imports of U.S.-origin agricultural goods. In an ancillary way, Canada contends (i) that tariffification has not affected United States access to the Canadian market and (ii) that the United States is pursuing vis-à-vis Canada the very policy that it is challenging in these proceedings.

### **C. The obligation to tariffify**

59. In support of its contention that it was required to tariffify existing non-tariff barriers to trade in agricultural goods, Canada points to the *WTO Agreement on Agriculture*, noting that this obliged Canada, the United States and all other WTO Members "to convert or tariffify all import-restrictive measures to tariffs of equivalent protective effect".<sup>38</sup> In particular, Canada points to Article 4.2 of the *WTO Agreement on Agriculture*<sup>39</sup> and the Modalities Document,<sup>40</sup> the latter of which, in Canada's contention, "provided the formal framework"<sup>41</sup> within which tariffification occurred.

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<sup>36</sup> Counter-Submission of Canada, at para.17.

<sup>37</sup> Counter-Submission of Canada, at para.21 and Schedule.

<sup>38</sup> Counter-Submission of Canada, at para.67.

<sup>39</sup> See paragraph 39 *supra*.

<sup>40</sup> See paragraphs 36-37 *supra*.

<sup>41</sup> Counter-Submission of Canada, at para.70.

60. In response to questions from the Panel, Canada noted that "the modalities was the foundation for the final conclusion of the *Agreement on Agriculture*".<sup>42</sup> While

[t]he Modalities Document may not itself have treaty status, ... it is an essential part of the context and background without which Article 4.2 [of the *Agreement on Agriculture*] cannot be understood.<sup>43</sup>

61. The United States challenges this construction of the *WTO Agreement on Agriculture* and the Modalities Document. In the United States contention,

there is no requirement to tariffy. There is a requirement not to maintain these barriers once the *Agreement on Agriculture* entered into force, but there is no requirement to have to substitute a tariff equivalent for them.<sup>44</sup>

62. Tariffication was, therefore, in the view of the United States, an option, a permitted facility, not an obligation or requirement.

**D. The application of the tariffs resulting from tariffication to over-quota imports of U.S.-origin agricultural goods under the NAFTA**

**(a) The Canadian case**

63. Canada's argument in support of its contention that it is entitled under the NAFTA to apply the tariffs created by the process of tariffication to over-quota imports of U.S.-origin agricultural goods rests on its view of the interrelationship of the FTA, the NAFTA and the *WTO Agreement on Agriculture*. The central element

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<sup>42</sup> Oral Submission of Canada, Transcript, at p.127.

<sup>43</sup> Oral Submission of Canada, Transcript, at p.350. Elsewhere in its submissions, Canada states: "Whether the *Modalities* is treated as part of the context under Article 31(2)(b) of the Vienna Convention, or simply as a form of *travaux préparatoires*, its significance is [sic] illuminating the intention of Article 4.2 is clear." (Second Submission of Canada, at para.63, note S-47.)

<sup>44</sup> Oral Submission of the United States, Transcript, p.235.

of this argument is that, through NAFTA Annex 702.1,<sup>45</sup> which incorporated FTA Article 710,<sup>46</sup> Canada and the United States agreed that over-quota trade in agricultural goods would continue to be governed by multilateral arrangements. Thus, prior to the entry into force of the *WTO Agreement on Agriculture*, bilateral trade in the goods in question had been subject to quantitative import restrictions justified by reference to GATT Article XI:2(c)(i), the GATT PPA or a GATT waiver. With the entry into force of the *WTO Agreement on Agriculture* on January 1, 1995, and pursuant to the obligation therein to tariffify existing non-tariff barriers, over-quota trade in the goods in question could no longer be subject to non-tariff barriers but would be subject instead to the tariff equivalents that had been established in the context of tariffication.

64. In Canada's view, the proposal to tariffify, first advanced in the Uruguay Round by the United States, and the obligation so to do subsequently assumed under the *WTO Agreement on Agriculture*, referred "not to the abandonment of protective measures but [to] the conversion from non-tariff barriers to tariff measures which offered equivalent protection".<sup>47</sup>

65. So, by incorporating FTA Article 710,

... the NAFTA also incorporates the tariffication regime resulting from the Uruguay Round of GATT multilateral negotiations; that is, as a matter of pure textual interpretation, the Uruguay Round results are within the ambit of Article 710 of the FTA as incorporated into the NAFTA.<sup>48</sup>

66. Canada's argument rests on the following chain of reasoning. First, under the FTA, Canada and the United States agreed, in FTA Chapter Four, on a staged elimination of tariffs. In respect of trade in certain agricultural goods, however, they also agreed in FTA Chapter Seven to the maintenance of various non-tariff barriers to imports. In particular, the continued application of non-tariff barriers was addressed in FTA Article 710 in which the Parties retained "their rights and obligations ... under the *General Agreement on Tariffs and Trade* (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI".

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<sup>45</sup> See paragraph 47 *supra*.

<sup>46</sup> See paragraph 26 *supra*.

<sup>47</sup> Oral Submission of Canada, Transcript, at pp.85-86.

<sup>48</sup> Oral Submission of Canada, Transcript, at p.109.

67. On this basis, under the FTA, Canada maintained quantitative restrictions on over-quota imports of the goods which are the subject of the present proceedings.

68. Second, unable to reach agreement on a new regime on market access in respect of agricultural trade in the NAFTA negotiations, Canada and the United States agreed instead to continue the arrangements adopted under the FTA. The NAFTA, therefore, in Canada's contention, simply carried forward the FTA deal "lock, stock and barrel, by incorporating those relevant articles of the *Free Trade Agreement* by reference".<sup>49</sup> In this regard, Canada points to NAFTA Annex 702.1<sup>50</sup> which, in paragraph 1, expressly incorporates into the NAFTA FTA Articles 701, 702, 704, 705, 706, 707, 710 and 711.

69. Third, Canada argues that a central aspect of the incorporation of the FTA agricultural arrangements into the NAFTA was agreement by the Parties to defer agreement on over-quota access until the multilateral trade negotiations. In this context, Canada relies on various statements by United States officials and agencies.

70. Canada also notes that throughout the NAFTA negotiations the Parties "were well aware of the possible level of tariff equivalents in Canada if the Uruguay Round proposals were to be accepted".<sup>51</sup> In Canada's view, therefore, the agreement by the Parties to defer agreement on over-quota access until the Uruguay Round negotiations was made in full knowledge of the possibility of tariffication and of the implications that this would have.

71. Fourth, Canada contends that the agreement of the Parties to address the issue of over-quota access in respect of their bilateral trade in the context of multilateral arrangements under the Uruguay Round is embodied in NAFTA Article 702(1) and Annex 702.1. In particular, Canada points to NAFTA Annex 702.1(1) which incorporates into the NAFTA, *inter alia*, FTA Article 710 thereby preserving the rights and obligations of the Parties under the GATT and "agreements negotiated under the GATT". Canada also relies on the text of the NAFTA more broadly, on the *travaux préparatoires* of the NAFTA, on various other statements and documents said to indicate the intention of the Parties in the period of the negotiations, and on the subsequent practice of the Parties.

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<sup>49</sup> Oral Submission of Canada, Transcript, at p.104.

<sup>50</sup> See paragraph 47 *supra*.

<sup>51</sup> Counter-Submission of Canada, at para.72.

72. In this regard, Canada contends that the *WTO Agreement on Agriculture* is an "agreement negotiated under the GATT" within the meaning of FTA Article 710. This is apparent, Canada asserts, both from the language of the *Punta del Este Declaration*<sup>52</sup> of September 20, 1986, which launched the Uruguay Round negotiations, and from the *Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations*.<sup>53</sup> Canada also relies on the language of FTA Article 710, a common sense interpretation of its terms and the fact that, at the time of negotiation of both the FTA and the NAFTA, the Parties had the Uruguay Round negotiations in contemplation and an expectation that its results should be reflected in the operation of the FTA and the NAFTA.

73. As regards the language of FTA Article 710, Canada notes that nowhere does it refer to the "existing" rights and obligations of the Parties, the form of words used elsewhere in both the FTA and the NAFTA to refer to an already established set of rights or obligations. Canada further argues that

... the context points unequivocally toward a dynamic interpretation. The GATT has never been a static body of rules ... the rights and obligations that the Parties agreed to retain are those arising under the GATT *as an evolving system of law*, including the network of subsidiary agreements it has generated. This conclusion flows from the language of the agreement and from the negotiating context. It is confirmed by the inherent absurdity of freezing in 1989 a set of rights and obligations that was about to become obsolete -- if not already so -- and that would become increasingly anachronistic as time went on.<sup>54</sup>

74. It follows, in Canada's view, that the incorporation into the NAFTA of FTA Article 710 preserved the Parties' rights and obligations not only under the GATT as it was at the time the NAFTA was concluded but also under the emerging *WTO Agreement on Agriculture*, an agreement concluded "within the framework and under the aegis of" the GATT. By incorporating FTA Article 710, the NAFTA therefore also incorporated the tariffication regime on which the *WTO Agreement on Agriculture* was based.

75. Canada also draws support from the language of the NAFTA more broadly. In particular, Canada relies on NAFTA Article 309(1)<sup>55</sup> which "preserves the right of the Parties to impose import restrictions in accordance

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<sup>52</sup> See paragraph 28 *supra*.

<sup>53</sup> See paragraph 38 *supra*.

<sup>54</sup> Second Submission of Canada, at para.42.

<sup>55</sup> See paragraph 43 *supra*.

with Article XI of the GATT or in accordance with any 'equivalent provision of a successor agreement'.<sup>56</sup> Since, in Canada's view, tariff equivalents are the direct result of the renegotiation of the GATT Article XI disciplines, they are protected by the provisions of NAFTA Article 309 as the "equivalent provisions of a successor agreement".

76. Canada also relies on NAFTA Note 5<sup>57</sup> which, in its view, confirms the Parties' agreement "... to accept the application of these tariff equivalents to the agricultural goods in question for quantities beyond those granted preferential or in-quota access under the FTA and NAFTA".<sup>58</sup>

77. By way of alternative to its central proposition, Canada contends that, in the event of a conflict between its obligations under the NAFTA and under the *WTO Agreement on Agriculture*, its obligations under the *WTO Agreement on Agriculture* must prevail as, in accordance with accepted principles of international law, the "*WTO Agreement on Agriculture* is a later-in-time agreement between the same parties regarding the same subject matter".<sup>59</sup>

78. More generally, addressing the United States reliance on NAFTA Article 302(1) and (2), Canada notes that, while these provisions may be relevant, the dispute does not begin and end with NAFTA Chapter Three. In this regard, Canada relies both on NAFTA Article 300<sup>60</sup> and NAFTA Article 701<sup>61</sup> describing, respectively, the scope and coverage of NAFTA Chapter Three and the Section on agriculture in NAFTA Chapter Seven. In Canada's contention, while NAFTA Chapter Three provides for on-going market liberalization and applies to all goods, including agricultural goods, the arrangements set out therein are subject to the more specific sectoral rights and obligations set out elsewhere in Part Two of the NAFTA, including in Chapter Seven. The general

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<sup>56</sup> Counter-Submission of Canada, at para.105.

<sup>57</sup> Note 5 provides as follows:

**Article 302(1) and (2):** paragraphs 1 and 2 are not intended to prevent a Party from maintaining or increasing a customs duty as may be authorized by any dispute settlement provision of the GATT or any agreement negotiated under the GATT.

<sup>58</sup> Counter-Submission of Canada, at para.67 and note 43.

<sup>59</sup> Second Submission of Canada, at para.127.

<sup>60</sup> See paragraph 41 *supra*.

<sup>61</sup> See paragraph 44 *supra*.



rules on tariff reduction and elimination in NAFTA Chapter Three are therefore, in Canada's view, subject to the more specific conditions of market access in NAFTA Chapter Seven. In this context, the Parties agreed, in respect of the goods which are the subject of the present dispute, that over-quota imports would be governed by their rights and obligations under the GATT and agreements negotiated under the GATT.

79. In Canada's contention, therefore, the first point of reference in this dispute must be NAFTA Chapter Seven, not Chapter Three. More particularly, "with respect to agricultural goods, Chapter Seven is paramount as between these two chapters"<sup>62</sup> although Canada accepts that whether Chapter Seven is paramount to Chapter Three or merely an exception within the meaning of NAFTA Article 302(1) and (2), the result would be the same.

80. Finally, Canada contends that the approach advocated by the United States would lead to absurd and unreasonable results as (a) it would lead to conflict between the NAFTA and the *WTO Agreement on Agriculture*, a situation which the Parties did not intend, and (b) it would restore the *status quo ante* as between the Parties as, if FTA Article 710 does not incorporate the results of the Uruguay Round, the GATT Article XI regime as it existed when the FTA or the NAFTA entered into force would be retained as between Canada and the United States and would continue to govern the Parties' bilateral over-quota trade in the products in issue.

**(b) *The United States reply***

81. The United States response to Canada's argument rests on a different appreciation of the interrelationship of the FTA, the NAFTA and the *WTO Agreement on Agriculture* in the context of the present dispute. Central to this approach is the proposition that tariffs and non-tariff barriers are two distinct trade instruments: "tariffs are not interchangeable with non-tariff barriers",<sup>63</sup> different rules apply to each. This dispute, in the United States contention, is about tariffs, not about non-tariff barriers. The critical issue is, therefore, in the United States view, whether there is some provision in the NAFTA which permits Canada to maintain the tariffs that it has imposed.

82. Also prominent in the United States response is the perception that Canada, in failing to engage in negotiations over tariffication within the NAFTA<sup>64</sup> because of the initiative it was pursuing in the Uruguay Round

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<sup>62</sup> Oral Submission of Canada, Transcript, at p.94.

<sup>63</sup> Supplementary Written Submission of the United States, at para.50.

<sup>64</sup> See paragraphs 45-46 *supra*.

negotiations,<sup>65</sup> "took a high-stakes gamble with its barriers to imports of agricultural goods, and lost".<sup>66</sup> Within the NAFTA, signed in December 1992, Canada agreed to eliminate its tariffs on imports of all U.S.-origin agricultural products. It did so, in the United States contention, in the belief that it would be able to continue

to protect its market by imposing non-tariff barriers on those products, expecting that either there would be no multilateral obligation prohibiting all non-tariff barriers to imports of agricultural products (and even possibly that further exceptions would be created to the general ban on non-tariff barriers) or that it would reach a separate agreement with the United States to permit Canada to permanently rescind its NAFTA tariff commitments.<sup>67</sup>

83. However, the United States suggests that the reality was different. The *WTO Agreement on Agriculture*, the text of which was adopted on December 15, 1993, some 12 months after the NAFTA was signed and 17 days before it entered into force, required the elimination of all non-tariff barriers to imports of agricultural goods. By this time, Canada had, however, within the NAFTA, agreed to eliminate its tariffs on imports of U.S.-origin agricultural goods. It was thus faced with the obligation under the *WTO Agreement on Agriculture* to eliminate its non-tariff barriers and the prohibition under the NAFTA on increasing tariffs. As a result of its negotiating gamble, Canada was therefore faced with a requirement to remove its non-tariff barriers under one agreement and a prohibition on tariffing under another. The inability to resolve this conflict in negotiations with the United States, coupled with the imposition of tariffs on over-quota imports of U.S.-origin agricultural goods, led to the present dispute.

84. A third element of the United States reply is that, under GATT Article XXIV, the NAFTA is an exception to the GATT, not subject to it.

As a free trade agreement, the NAFTA is to eliminate the duties and other restrictive regulations of commerce on trade between the Parties. GATT Article XXIV specifically recognizes that as a result of the establishment of a free trade area, the free trade partners will not be applying to each other the tariff rates that they apply to their other multilateral trading partners. Instead, the free trade partners will be eliminating tariffs on each other's goods. As a result, the whole object and purpose of the NAFTA is precisely the opposite of what the Government of Canada is arguing should be the result in this case. The object and purpose of the NAFTA is to exempt

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<sup>65</sup> See paragraphs 30 and 34 *supra*.

<sup>66</sup> Oral Submission of the United States, Transcript, at p.13.

<sup>67</sup> Supplementary Written Submission of the United States, at para.19.

the NAFTA partners' products from each other's multilateral tariffs.<sup>68</sup>

85. Thus, in the United States contention, it is not sufficient for Canada simply to point to the WTO *Agreement on Agriculture* to establish an obligation to tariffify (assuming that such an obligation existed, which the United States denies<sup>69</sup>). Canada must also show that that multilateral obligation applied in the bilateral context of the agricultural provisions of the NAFTA which, *prima facie*, in view of GATT Article XXIV, operate outside the WTO trade in goods framework. In the United States contention, it is an "absurd proposition" to suggest that WTO tariff bindings constitute an exception to the NAFTA tariff bindings.<sup>70</sup> This argument would, in the United States view, "render meaningless all the NAFTA tariff bindings for agricultural, food, beverage and certain related goods".<sup>71</sup>

86. The United States also relies on GATT Article XXIV to rebut the Canadian argument that, in the event of a conflict between Canada's obligations under the NAFTA and its obligations under the WTO *Agreement on Agriculture*, its obligations under the latter agreement must prevail as the *Agreement on Agriculture* is an agreement later-in-time.

... [T]he WTO clearly contemplates [in Article XXIV of the GATT 1994] that free trade agreements may establish preferential tariff regimes among the parties to such free trade agreements, notwithstanding the tariff levels that would otherwise apply under the WTO. Accordingly, the WTO is not a later in time treaty that would prevail over the NAFTA.<sup>72</sup>

87. On this point, the United States also contends that the later-in-time rule has no application in the context of the present dispute as, "[i]n this instance, the WTO is not a successive treaty relating to the same subject matter as the NAFTA. The NAFTA is a free trade agreement establishing preferential treatment among the NAFTA parties. The WTO is a multilateral trade agreement providing for multilateral trading rules".<sup>73</sup>

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<sup>68</sup> Supplementary Written Submission of the United States, at para.23.

<sup>69</sup> See paragraphs 61-62 *supra*.

<sup>70</sup> Oral Submission of the United States, Transcript, at pp.19-20.

<sup>71</sup> Oral Submission of the United States, Transcript, at p.20.

<sup>72</sup> Supplementary Written Submission of the United States, at para.118.

<sup>73</sup> Supplementary Written Submission of the United States, at para.115.

88. The United States also refers to GATT Article XXIV in response to the Canadian argument of potential inconsistency between the Parties' obligations under the NAFTA and under the WTO *Agreement on Agriculture*.

89. On the substance, the United States responds to the Canadian argument as follows. First, the WTO *Agreement on Agriculture* is not an "agreement negotiated under the GATT" within the meaning of FTA Article 710. In this regard, the United States points to the language of the article and, in particular, the use therein of the word "retain"<sup>74</sup> which, in the United States view, points to "the retrospective intent of FTA Article 710".<sup>75</sup>

It is difficult to conceive how, when Article 710 entered into effect in 1989, the Parties were "retaining" rights and obligations under agreements that had not been negotiated yet and would not enter into force until six years later.<sup>76</sup>

90. In further support of this proposition, the United States points to NAFTA Annex 702.1(4)<sup>77</sup> which, in its contention, "explains what the Parties understood at the time to be the effect of incorporating FTA Article 710".<sup>78</sup> In the United States view, this paragraph qualifies or clarifies the scope of FTA Article 710 as incorporated into the NAFTA. In particular, the absence from this paragraph of any reference to "agreements negotiated under the GATT" is instructive.

Since the Parties explicitly stated that what Article 710 does is incorporates [sic] their GATT rights, ... it can be inferred that, since they deliberately did not say that they incorporated the rights under any agreements negotiated under the GATT, they were not intending that incorporation to have that effect.<sup>79</sup>

91. More generally, the United States contends that the reference to "agreements negotiated under the GATT" in FTA Article 710 "is not to the WTO, but to the existing agreements negotiated under the GATT at

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<sup>74</sup> "Unless otherwise specifically provided in this Chapter, the Parties *retain* their rights and obligations ..." (emphasis added)

<sup>75</sup> Supplementary Written Submission of the United States, at para.58.

<sup>76</sup> Supplementary Written Submission of the United States, at para.58.

<sup>77</sup> See paragraph 47 *supra*.

<sup>78</sup> Supplementary Written Submission of the United States, at para.54.

<sup>79</sup> Oral Submission of the United States, Transcript, at p.65.

the time the FTA was concluded".<sup>80</sup> In this regard, the United States draws attention to various agreements, or Codes, concluded as a result of the Tokyo Round multilateral trade negotiations.

92. Also in support of the proposition that FTA Article 710 is not forward-looking, the United States notes that, where the Parties wanted to refer, in the FTA and the NAFTA, to future arrangements, they did so clearly by the use of different language. Thus, the United States points to various places in the FTA where explicit reference was made to the Uruguay Round. Similarly, the NAFTA refers on occasion to "any successor agreement",<sup>81</sup> thereby, in the United States view, "making it clear that agreements negotiated under the GATT were distinct from future agreements".<sup>82</sup>

93. The United States further contends that Canada had itself previously expressed the view that FTA Article 710 does not incorporate the results of the Uruguay Round. In this regard, the United States points to statements made by Canada recorded in the *GATT Report of the Working Party on the Free-Trade Agreement between Canada and the United States* ("GATT Working Party Report").<sup>83</sup>

94. Second, in the alternative, the United States contends that, even if the *WTO Agreement on Agriculture* is an "agreement negotiated under the GATT" pursuant to FTA Article 710, there is nothing in that agreement which constitutes an exception to the NAFTA tariff bindings. This proposition rests on two contentions: (a) that the *WTO Agreement on Agriculture* does not require tariffification;<sup>84</sup> and (b) that, pursuant to GATT Article XXIV, "[t]here is no inconsistency between the tariffs a country maintains under the WTO with respect to imports from the rest of its trading partners and the preferential tariffs the country provides to its free trade agreement partners".<sup>85</sup>

95. Third, whether or not the *WTO Agreement on Agriculture* is an "agreement negotiated under the GATT"

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<sup>80</sup> Supplementary Written Submission of the United States, at para.57.

<sup>81</sup> See, for example, NAFTA Article 2005(1).

<sup>82</sup> Supplementary Written Submission of the United States, at para.60.

<sup>83</sup> GATT Document L/6927; BISD 38S/47.

<sup>84</sup> See paragraphs 61-62 *supra*.

<sup>85</sup> Oral Submission of the United States, Transcript, at p.25.

pursuant to FTA Article 710, the United States contends that FTA Article 710 was focused on non-tariff barriers:

... Article 710 was only intended ... [to bring] in the Protocol [of] Provisional Application, Article XI and the waiver, or Section 22 ... It has never been used for anything else. Whatever it might say about tariffs, it certainly is not saying that a party maintains its GATT tariffs with respect to the Parties on these goods. So, to that extent, with respect to tariff treatment, it is not covering tariff treatment in that sense.<sup>86</sup>

96. Thus, just because NAFTA Annex 702.1 incorporates FTA Article 710, this does not mean that the whole of the WTO is incorporated.

97. The United States also notes that, where Canada sought to incorporate tariffication into its NAFTA commitments, it did so expressly. In this regard, the United States points to NAFTA Annex 703.2, Section B, paragraph 4 which, in addressing the agricultural arrangements that apply between Canada and Mexico, refers specifically to tariffication.<sup>87</sup> More particularly, the United States also observes that Canada and the United States did in fact have some limited discussions on tariffication within the NAFTA in the course of 1992 but that those talks broke down. The incorporation of FTA Article 710 into the NAFTA does not therefore represent agreement by the Parties to incorporate tariffication.

98. Fourth, the United States also takes issue with Canada's reliance on NAFTA Article 309(1) and NAFTA Note 5. In respect of NAFTA Article 309(1), referring to the text of that provision,<sup>88</sup> the United States notes that

the obvious equivalent provision under the WTO to Article XII [sic] of the GATT 1947 is Article XI of the GATT 1994. Furthermore, Article XI is a rule prohibiting non-tariff barriers

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<sup>86</sup> Oral Submission of the United States, Transcript, at p.256.

<sup>87</sup> Paragraph 4 provides:

Notwithstanding Article 302(2) (Tariff Elimination), where an agreement resulting from agricultural multilateral trade negotiations under the GATT enters into force with respect to a Party pursuant to which it has agreed to convert a prohibition or restriction on its importation of an agricultural good into a tariff rate quota or a customs duty, that Party may not apply to such good that is a qualifying good an over-quota tariff rate that is higher than the lower of the over-quota tariff rate in:

- (a) its Schedule to Annex 302.2, and
- (b) that agreement,

and paragraph 3 shall no longer apply to the other Party with respect to that good.

<sup>88</sup> See paragraph 43 *supra*.

with certain narrow exceptions that are subject to numerous and difficult conditions, whereas Canada's tariff bindings are first tariffs, rather than non-tariff barriers, and secondly, not a provision or rule but simply the maximum tariff level that Canada may apply under the WTO. It is impossible to see how a broad rule applicable to all GATT 1947 contracting parties prohibiting an entire range of non-tariff barriers is equivalent to a particular tariff rate in Canada's tariff schedule.<sup>89</sup>

99. In respect of Canada's reliance on NAFTA Note 5,<sup>90</sup> the United States observes that "[t]he Note embodied a trilateral understanding that Article 302 should not be read to prohibit GATT-approved trade retaliation".<sup>91</sup> In the United States contention, the Note refers "only to tariff increases authorized through dispute settlement".<sup>92</sup>

100. The United States also rejects, by reference to the plain language of the text, the Canadian argument that NAFTA Chapter Seven prevails over NAFTA Chapter Three. In the United States contention, therefore, Canada needs to establish a specific exception to NAFTA Article 302.

101. Similarly, the United States takes issue with Canada's reliance on the *travaux préparatoires* of the NAFTA and the *WTO Agreement on Agriculture*, and other documentation referred to for the purpose of ascertaining the attitude of the Parties during the period of negotiation, and on subsequent practice. In this regard, while noting that the Panel's terms of reference do not permit it to examine the application by the United States of tariffs on over-quota imports from Canada, the United States nevertheless notes that "these measures do not establish any agreement of the parties that the NAFTA is to be interpreted contrary to its terms, object, purpose and context ..."<sup>93</sup>

102. The United States also notes that its position on the effect of WTO tariffication under the NAFTA was known to Canada at an early stage, and certainly before the conclusion of the NAFTA negotiations. The risks associated with the Canadian negotiating strategy in both the NAFTA and the Uruguay Round were thus readily

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<sup>89</sup> Oral Submission of the United States, Transcript, at p.39.

<sup>90</sup> See note 57 *supra*.

<sup>91</sup> Supplementary Written Submission of the United States, at para.111.

<sup>92</sup> Oral Submission of the United States, Transcript, at p.41.

<sup>93</sup> Supplementary Written Submission of the United States, at para.105.

apparent. Canada cannot, therefore, now rely on the incorporation of FTA Article 710 as an indicator of the agreement of the Parties on the application of WTO tariffication under the NAFTA.

103. Finally, referring to the 1989 GATT Panel Report on *Canada - Import Restrictions on Ice Cream and Yoghurt*<sup>94</sup> the United States notes that

there was no agreement that Canada could maintain any particular non-tariff barriers under the FTA. ... any barriers that either Party were to maintain against each other would have had to be justified under the rules of the [GATT] ...

So one cannot assume that the non-tariff barriers that Canada was maintaining against the United States were in fact consistent with the FTA or with the NAFTA.<sup>95</sup>

104. The United States also rejects Canada's contention that the United States approach would have the effect of restoring the *status quo ante* between the Parties, thereby enabling Canada to re-apply its non-tariff barriers to over-quota imports of the U.S.-origin goods in question.<sup>96</sup>

**(c) *The Canadian rejoinder***

105. In addition to the arguments already noted, Canada responds to the United States reply on the question of the interpretation of FTA Article 710 noting, in particular, that

[t]he United States has presented the Panel with two absolute positions. Either FTA Article 710 is wholly inapplicable to tariff measures of any kind, or else it gives overriding effect to all WTO tariffs, in which case the entire basis for preferential trade in agricultural goods is destroyed. ...

The Panel need not choose between the two unreasonable extremes postulated ... The correct position is one that gives "appropriate effects" to the language, but not unlimited or destructive effects.<sup>97</sup>

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<sup>94</sup> Report of the Panel adopted at the Forty-fifth Session of the CONTRACTING PARTIES on 5 December 1989; L/6568; BISD 36S/68.

<sup>95</sup> Oral Submission of the United States, Transcript, at pp.269-270.

<sup>96</sup> See paragraph 80 *supra*.

<sup>97</sup> Second Submission of Canada, at paras.22-23.



106. In this regard, Canada also notes, in response to the United States argument based on NAFTA Annex 702.1(4)<sup>98</sup> that this provision was specifically intended to address United States concern over alcoholic beverages and was not therefore intended as an amendment or repeal of the original FTA Article 710.

Annex 702.1(4), on its face, is a clarification and not an amendment of Article 710. It is a paraphrase and not, as implied by this U.S. submission, a partial repeal. It is properly resorted to as a means of clarifying the content of Article 710, but not as a means of reducing its scope.<sup>99</sup>

107. On the issue of its import restrictions on ice cream and yogurt, Canada contends that tariffication was intended to apply to all non-tariff measures, regardless of whether they were previously GATT-compatible. "Tariffication was therefore used by a number of participants as an amnesty for measures of varying degrees of conformity with the GATT".<sup>100</sup> Whatever might have been the status of the Canadian non-tariff barriers under GATT Article XI:2(c)(i), "[f]ollowing the conclusion of the Uruguay Round, there is no basis for looking behind the WTO Agreement to examine the legitimacy of any of Canada's tariffied measures".<sup>101</sup>

#### **E. Observations of Mexico**

108. Noting that it has no specific commercial interest in the dispute, Mexico nonetheless stresses that it has a substantial interest in the legal relationship between the NAFTA and the WTO Agreements, as well as with respect to other issues concerning the interpretation of NAFTA provisions that may be examined in the procedure.<sup>102</sup>

109. While, in Mexico's view, the NAFTA Parties intended to liberalize trade between them to a greater extent than was provided in the GATT, the NAFTA does not eliminate all barriers to trade. Furthermore, "[i]nsofar as Chapter Seven (Agriculture and Sanitary and Phytosanitary Measures), the NAFTA Parties were clearly mindful

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<sup>98</sup> See paragraph 90 *supra*.

<sup>99</sup> Second Submission of Canada, at para.50.

<sup>100</sup> Second Submission of Canada, at para.112.

<sup>101</sup> Second Submission of Canada, at para.116.

<sup>102</sup> First Submission of Mexico (English translation), at para.3.

of the then on-going trade negotiations of the Uruguay Round".<sup>103</sup>

110. Highlighting the considerable number of provisions in the NAFTA which refer in terms to the GATT, "agreements negotiated under the GATT", "successor agreements", the "Uruguay Round" and other agreements concluded within the framework of the GATT, Mexico submits, therefore, that

the interaction between the Parties' multilateral, trilateral, and bilateral rights and obligations must be carefully analyzed on a case by case basis. ... [G]eneralizations about NAFTA's primacy over the WTO (or vice versa) cannot be made.<sup>104</sup>

111. In particular, Mexico expresses some concern lest the Panel construe the NAFTA in a manner which could have implications beyond this case by reference to provisions of the FTA, an agreement to which Mexico was not a party. The NAFTA should, therefore, in Mexico's submission, be interpreted on the basis of its own terms and conditions.

112. Mexico also expresses some concern at the argument advanced by Canada, in the context of its reliance on subsequent practice, that non-objection or silence by one Party in the face of conduct by another equals consent or acquiescence to conduct that may be in violation of the Agreement. In particular, Mexico contends that the fact that an objection to a given statement or conduct "was not made at the due time ... does not mean that the right is being renounced of invoking the objection or the possible violation at a later time".<sup>105</sup>

## **VII. DECISION OF THE PANEL**

### **(1) Analysis**

#### ***A. Preliminary matters***

##### ***(a) Identification of the issue***

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<sup>103</sup> First Submission of Mexico (English translation), at para.10(d).

<sup>104</sup> First Submission of Mexico (English translation), at para.11.

<sup>105</sup> Oral Submission of Mexico, Transcript (English translation), at pp.6-8.

113. The issue in this case is whether the customs duties imposed by Canada on certain U.S.-origin agricultural products following "tariffication" in accordance with the agreements reached as a result of the Uruguay Round are in breach of the relevant provisions of the NAFTA. The United States argues that these duties are in breach of NAFTA Article 302 paragraphs (1) and (2), which provide:

1. Except as otherwise provided in this Agreement, no Party may increase any existing customs duty, or adopt any customs duty, on an originating good.
2. Except as otherwise provided in the Agreement, each Party shall progressively eliminate its customs duties on originating goods in accordance with its Schedule to Annex 302.2.

114. Canada's response is that the obligation to "tariffy" arising out of the Uruguay Round agreements (in particular the *WTO Agreement on Agriculture*) has been incorporated into the NAFTA. In Canada's view, this was done by FTA Article 710 which was itself made part of the NAFTA by NAFTA Annex 702.1(1).

115. FTA Article 710 provides:

Unless otherwise specifically provided in this Chapter, the Parties retain their rights and obligations with respect to agricultural, food, beverage and certain related goods under the *General Agreement on Tariffs and Trade* (GATT) and agreements negotiated under the GATT, including their rights and obligations under GATT Article XI.

116. According to Canada, this provision takes precedence over the obligation in NAFTA Article 302 not to "increase" or "adopt" any customs duty.

117. This case then involves the complex interrelationship of the FTA, the NAFTA, the GATT, and the agreements of the WTO, in particular the *WTO Agreement on Agriculture*. In seeking to support their differing interpretations of these various agreements, the disputing Parties ("the Parties") have directed the Panel to the actual wording used, to the object and purpose of the agreements, to preparatory work, and to the practice of the Parties, both contemporaneous and subsequent. Needless-to-say, the Parties are not in agreement as to the relevance or weight to be given to these considerations. It is therefore to the question of the proper approach to the interpretation of treaties that the Panel first turns.

(b) *Approach to interpretation*

118. The starting point in the interpretation of the NAFTA is NAFTA Article 102(2), which provides:

The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

119. The applicable rules of international law include, the Parties agree, Articles 31 and 32 of the *Vienna Convention on the Law of Treaties 1969* ("the Vienna Convention"),<sup>106</sup> which are generally accepted as reflecting customary international law.<sup>107</sup>

120. The basic proposition of Article 31 is as follows: "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". The Panel must therefore commence with the identification of the plain and ordinary meaning of the words used. In doing so, the Panel will take into consideration the meaning actually to be

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<sup>106</sup> Articles 31 and 32 provide:

**Article 31: General rule of interpretation**

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.
2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
  - (a) any agreement relating to the treaty which was made between all the parties in connexion with the conclusion of the treaty;
  - (b) any instrument which was made by one or more parties in connexion with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.
3. There shall be taken into account, together with the context:
  - (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
  - (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
  - (c) any relevant rules of international law applicable in the relations between the parties.
4. A special meaning shall be given to a term if it is established that the parties so intended.

**Article 32: Supplementary means of interpretation**

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable.

<sup>107</sup> See *Territorial Dispute (Libyan Arab Jamahiriya/Chad)*, ICJ Reports 1994, p.6, at p.21, para.41, reaffirmed in *Maritime Delimitation and Territorial Questions Between Qatar and Bahrain (Jurisdiction and Admissibility)*, ICJ Reports 1995, p.6, at p.21, para.33. This view is also reflected in the decisions of the WTO Appellate Body; see, most recently, *Japan - Taxes on Alcoholic Beverages*, at section D; AB-1996-2, adopted on November 1, 1996.

attributed to words and phrases looking at the text as a whole, examining the context in which the words appear and considering them in the light of the object and purpose of the treaty.

121. Subsequent agreement and subsequent practice are also factors which Article 31 of the Vienna Convention specifically directs should be taken into account together with the context. The Panel further notes the admissibility of recourse to supplementary means of interpretation, including preparatory work, pursuant to Vienna Convention Article 32 in order to confirm the meaning resulting from the application of the rule in Vienna Convention Article 31 or to determine the meaning when an interpretation in accordance with Vienna Convention Article 31 leaves the meaning ambiguous or obscure or leads to results which are manifestly absurd or unreasonable.

122. The Panel also attaches importance to the trade liberalization background against which the agreements under consideration here must be interpreted. Moreover, as a free trade agreement the NAFTA has the specific objective of eliminating barriers to trade among the three contracting Parties. The principles and rules through which the objectives of the NAFTA are elaborated are identified in NAFTA Article 102(1) as including national treatment, most-favoured-nation treatment and transparency.<sup>108</sup> Any interpretation adopted by the Panel must, therefore, promote rather than inhibit the NAFTA's objectives. Exceptions to obligations of trade liberalization must perforce be viewed with caution.<sup>109</sup>

123. The interpretation of these agreements is complicated by a number of factors. The NAFTA incorporates obligations from other agreements including both the FTA and the GATT. The terminology used in the drafting of various provisions, both within and across these agreements, is not marked by uniformity or consistency. As discussed more fully below, words like "existing", "retain" or "successor agreements", appear in some contexts yet do not appear in others where their presence might have been thought apposite. As a result, the Panel has been faced not only with the task of determining meaning from the presence of certain words, but also with the

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<sup>108</sup> Article 102 provides, *inter alia*:

1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favoured-nation treatment and transparency are to:
  - (a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
  - ....

<sup>109</sup> The principle that exceptions to general obligations are to be construed narrowly is well accepted in the interpretation of the GATT: see, *inter alia*, Report of the Panel on *Canada - Import Restrictions on Ice Cream and Yoghurt*, note 94, *supra*, at para.59.

more difficult task of divining meaning from the absence of particular words.

124. Additionally, Mexico has expressed its concern to the Panel that the NAFTA be interpreted as an agreement on its own terms, and that that interpretation not be governed by the interpretation of the FTA to which Mexico is not a party. The Panel has borne this concern in mind in carrying out its task of interpreting the NAFTA.

(c) *Burden of proof*

125. In its deliberations, the Panel has been guided by the NAFTA Model Rules.<sup>110</sup> Rules 33 and 34 state as follows:

33. A Party asserting that a measure of another Party is inconsistent with the provisions of the Agreement shall have the burden of establishing such inconsistency.

34. A Party asserting that a measure is subject to an exception under the Agreement shall have the burden of establishing that the exception applies.

126. Canada points out that, as complainant, the United States has the initial burden of proving its complaint, citing Rule 33. The United States does not contest this point, but contends that it has satisfied this burden by its demonstration that Canada has increased customs duties on certain agricultural products contrary to NAFTA Article 302. The United States further argues that Canada's justification of its actions amounts to an argument that an exception to NAFTA Article 302 must apply, and that Rule 34 of the Model Rules places the burden of establishing the exception on Canada.

127. The Panel finds that the United States has met the requirement of Rule 33 of the Model Rules by establishing a *prima facie* case of inconsistency with the NAFTA. The increase in Canadian tariffs by the imposition of tariffs on the over-quota imports of the goods in question on its face violates the straightforward prohibition contained in the words of NAFTA Article 302.

128. Since the United States has established a *prima facie* case, the Panel's principal concern has been to

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<sup>110</sup> See note 2 *supra*.

determine whether Canada has shown either that its actions are not inconsistent with, or that they fall under an exception to, NAFTA Article 302. The principal focus of Canada's argument has been on the provisions of NAFTA Chapter Seven relating to agricultural products. Both Parties have offered considerable evidence and argument concerning the interpretation and relevance of these provisions, and the Panel does not find it necessary to resolve any issue on the basis that a Party has failed to discharge the burden of proof resting on it.

**B. *The central issues in dispute***

129. Canada does not deny that it has established the tariffs in question and has applied them to the U.S.-origin agricultural goods. Nor does it deny that NAFTA Article 302 operates to prevent the NAFTA Parties from increasing customs duties or imposing new duties. It argues, however, that its actions in imposing tariffs on over-quota imports of agricultural products were in fulfilment of its obligations under the *WTO Agreement on Agriculture*. These obligations, according to Canada, are binding under the NAFTA by virtue of FTA Article 710 which is one of the provisions incorporated into the NAFTA by paragraph 1 of NAFTA Annex 702.1.

130. The United States disputes this on the ground that the reference in FTA Article 710 to the GATT and agreements negotiated under the GATT is not prospective and hence does not apply to agreements resulting from the Uruguay Round. The United States also argues that in any event the *WTO Agreement on Agriculture* imposes no obligation to tariffify. Even if it did, the United States claims, FTA Article 710 could not serve to carry such an obligation into the NAFTA. FTA Article 710 is focused on non-tariff barriers. Nothing in FTA Article 710 could override the obligations in NAFTA Chapter Three not to increase tariffs and not to introduce new tariffs.

131. The Panel will now address in turn each of these considerations - the temporal application of FTA Article 710, the substantive application of FTA Article 710, and the relationship between NAFTA Chapters Three and Seven.

*(a) The temporal application of FTA Article 710*

132. Canada argues that the effect of FTA Article 710 is to make rights and obligations under the GATT, and under any agreement negotiated under the GATT, even subsequent to the entry into force of the NAFTA, part of the NAFTA. This has the effect, in Canada's view, of making obligations under the *WTO Agreement on*

*Agriculture* part of the NAFTA. The WTO *Agreement on Agriculture*, Canada claims, is an "agreement negotiated under the GATT". The United States, on the other hand, argues that FTA Article 710 refers only to rights and obligations under the GATT or under agreements negotiated under the GATT existing at the time that the FTA entered into force or, at the most, existing at the time the NAFTA entered into force.<sup>111</sup>

133. The Panel is therefore confronted with the question whether the rights and obligations retained under FTA Article 710, as subsequently incorporated into the NAFTA, are limited to those established under the GATT and its related agreements as at the time of the entry into force of the FTA or of the NAFTA, or whether they extend to later established rights and obligations. Given the incorporation of FTA Article 710 into the NAFTA, the critical date for the operation of FTA Article 710 is, in the Panel's view, the date of entry into force of the NAFTA. However, the most convenient way to approach the matter is to look initially at the meaning of FTA Article 710 in the context of the FTA and then determine whether that meaning was changed when FTA Article 710 was brought into the NAFTA.

(i) *The meaning of Article 710 in the FTA*

134. The United States argues that the use of the verb "retain" in FTA Article 710 is conclusive. That word, in its view, means "to *continue* to have, use, recognize, accept etc." and one cannot continue to have something that is not yet in existence.<sup>112</sup> In the view of the Panel, the issue of the temporal application of FTA Article 710 is not resolved simply by reference to the terms of the article itself. The Panel does not accept that the meaning of the word "retain" is as restricted as the United States contends; one can "retain" rights that exist in the present, and one can also "retain" rights under a regime that evolves and extends into the future. An obvious example of this is found in FTA Article 1608(2) under which, "[e]ach Party and investors of each Party retain their respective rights and obligations under customary international law ...." Clearly, this reference to "customary international law" is a reference to an evolving system. Yet the Parties found it quite appropriate to use the word "retain".

135. As the words of FTA Article 710 are on their face capable of bearing two meanings, either GATT rights and obligations in existence at the date of the incorporation of FTA Article 710 or both existing rights and

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<sup>111</sup> The United States stated to the Panel that the difference between the date of entry into force of the FTA and the date of entry into force of the NAFTA is of no significance since no new GATT rights or obligations emerged nor were any new agreements negotiated in the intervening period.

<sup>112</sup> Supplementary Written Submission of the United States, at para.58.



obligations and those which come into existence through subsequently negotiated agreements, the Panel must look elsewhere for guidance regarding which of the two meanings more closely represents the intention of the Parties.

136. The Panel does so, in accordance with Article 31 of the Vienna Convention, by considering the words of FTA Article 710 in their context and in the light of the object and purpose of the agreement as a whole. It is apparent that in the FTA the Parties had other means available to them for limiting the operation of FTA Article 710 to existing rights and obligations if this is what they had intended to achieve. The word "existing", which according to FTA Article 201 means "in effect at the time of the entry into force of this Agreement", could have been introduced. "Existing" was used in FTA Article 104, which constitutes a general affirmation of rights and obligations under bilateral and multilateral agreements to which both states are parties. The use of the word "existing" would have made it clear that the "rights and obligations" referred to were only those in existence at the time that the agreement entered into force.

137. In other contexts the Parties were able to express their intention to preserve only existing GATT rights and obligations. Thus, FTA Article 501 provides that each Party is to accord national treatment to the goods of the other "in accordance with the existing provisions of Article III of the *General Agreement on Tariffs and Trade* (GATT) ...." (emphasis added). Paragraph 2 provides that national treatment is to be applied "in accordance with existing interpretations adopted by the Contracting Parties to the GATT" (emphasis added). Moreover, when the Parties made express provision that subsequent modifications to the *GATT Agreement in Government Procurement* "shall automatically be incorporated into and made part of" the FTA,<sup>113</sup> it was where they had already provided in the title to the preceding article<sup>114</sup> that they were reaffirming only "existing obligations" under that Agreement. But such explicit language limiting the scope of FTA Article 710 to existing rights and obligations cannot be found. The absence of such wording carries an implication that future rights and obligations were not excluded.

138. This inference is strengthened by the use of similar wording elsewhere in the FTA where a prospective application must surely have been intended. FTA Article 1801(2) falls into this category. This article provides that disputes "arising under both this Agreement and the *General Agreement on Tariffs and Trade*, and agreements negotiated thereunder (GATT) may be settled in either forum, according to the rules of that forum

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<sup>113</sup> FTA Article 1303(2).

<sup>114</sup> FTA Article 1302.

..." It seems unlikely that the Parties agreed in FTA Article 1801 that the option of choosing between GATT and FTA dispute settlement applied only to disputes arising under the GATT and negotiated agreements, or to the rules of either forum, only as they existed on January 1, 1989, and that no such right would have applied in respect of any developments under the GATT or to any agreements negotiated after that time.<sup>115</sup> In other words, reference to the GATT and agreements negotiated under the GATT must have been a reference to the GATT not as a fixed body of law but as one that was capable of developing.

139. This, it seems to the Panel, is the essence of Canada's argument that the reference to the GATT in FTA Article 710 had to be understood as a reference to "an evolving system of law".<sup>116</sup> The GATT is more than a static set of rights and obligations. Based on a set of principles embodied in the *General Agreement*, the GATT has been developed, clarified and supplemented by subsequent legal instruments through successive negotiating rounds, into a complex of substantive and procedural rules. That process was continuing even as the Parties negotiated the FTA. They could hardly have been unaware of such considerations when they referred in their agreement to the GATT and to agreements negotiated under it.

140. Canada claims that the United States argument deprives the reference to "agreements negotiated under the GATT" in FTA Article 710 of any content if the expression does not extend to Uruguay Round agreements. There were, Canada argues, no agreements of significance dealing with agricultural matters negotiated under the GATT that existed at the time the FTA was concluded that would have induced the Parties to include such a reference in FTA Article 710. The United States response is that FTA Article 710 was referring to the agreements negotiated within the framework of the Tokyo Round, citing the "Standards Code" and the "Subsidies Code". Although Canada argues that the relevance of these agreements to the agricultural regime contemplated by FTA Article 710 is minimal if not non-existent, the Panel accepts that there is some possible content to which the FTA Article 710 reference to "agreements negotiated under the GATT" could apply if it is construed as applying to the agreements in existence at the time of the entry into force of the FTA. Thus, the Panel does not find this particular Canadian argument conclusive.

141. On examining statements made by officials following the conclusion of the FTA, the Panel is unable to

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<sup>115</sup> It is to be noted that the equivalent provision in NAFTA Article 2005 adds the words "or any successor agreement (GATT)". The terminology of a "successor agreement" was not employed at the time the FTA was drafted although it was commonly used as a drafting device in the NAFTA. This matter is discussed further at paragraphs 149-150 *infra*.

<sup>116</sup> Second Submission of Canada, at para.42.

find any definitive support there for either Party's interpretation of FTA Article 710. Canada cites several examples of such statements made by United States officials to the effect that liberalization in agriculture had not been achieved in the FTA and that it had been put off to the Uruguay Round. But these statements do not deal with the critical issue of whether the results of the Uruguay Round would be incorporated automatically into the FTA.

142. The United States, for its part, refers to statements made by Canada before the GATT Working Party on the FTA.<sup>117</sup> The GATT Working Party Report indicates that the representative of Canada stated that "[o]nly in government procurement was there an explicit commitment in the FTA to incorporate Uruguay Round results".<sup>118</sup> This, the United States claims, is a clear affirmation by Canada that "Article 710 does not incorporate Uruguay Round results".<sup>119</sup> Canada replies that this was simply a statement of fact; FTA Article 1303(3) provides the only "explicit" commitment in the NAFTA to incorporate Uruguay Round results.<sup>120</sup> Canada points out that other parts of the paragraph in question are supportive of its position.<sup>121</sup> The Panel is unable to attribute conclusive effect to paragraph 27 of the GATT Working Party Report.

143. The United States also refers to paragraph 77 of the GATT Working Party Report where it is stated that,

the Parties to the Agreement [Canada and the United States] noted that, of necessity, the FTA could only have reaffirmed GATT rights and obligations as these existed at the time the FTA entered into force but that, nevertheless, they would consider how Uruguay Round results would apply with respect to the FTA once these had been implemented.

144. On its face, if this statement was referring to FTA Article 710, then it would seem to be of considerable significance. However, an examination of the GATT Working Party Report suggests that paragraph 77 was referring to a Canadian statement in paragraph 30 of the same document about FTA Article 104 under which the

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<sup>117</sup> See note 83 *supra*.

<sup>118</sup> *Ibid.*, at para.27.

<sup>119</sup> Supplementary Written Submission of the United States, at para.68.

<sup>120</sup> Second Submission of Canada at para.54.

<sup>121</sup> An earlier reference in paragraph 27 of the GATT Working Party Report refers to the submission by Canada that, "...where Canada and the United States agreed to the Uruguay Round results, these would apply between the two parties and to all other contracting parties". The Report also refers to agriculture and intellectual property rights and adds that "[o]*utside of these areas*, there was no specific requirement to incorporate the results of the Uruguay Round into the FTA" (emphasis added).

Parties had affirmed their "existing" rights and obligations. As a result, the Panel does not find the above extract from paragraph 77 to be helpful in clarifying the meaning of FTA Article 710.

145. The Panel concludes therefore that the terms of FTA Article 710, considered in their context and in light of the object and purpose of the FTA as required by the Vienna Convention, are forward-looking.

*(ii) The effect of the incorporation of FTA Article 710 into the NAFTA*

146. The Panel must now consider whether the forward-looking character of FTA Article 710 was changed when it was incorporated into the NAFTA. Neither Party has suggested that the use of the word "incorporate" in NAFTA Annex 702.1 alone affects the content of FTA Article 710 or changes its forward-looking character. However, the United States regards the wording of paragraph 4 of NAFTA Annex 702.1 to be particularly significant. Paragraph 4 provides as follows:

The Parties understand that Article 710 of the *Canada-United States Free Trade Agreement* incorporates the GATT rights and obligations of Canada and the United States with respect to agricultural, food, beverage and certain related goods, including exemptions by virtue of paragraph (1)(b) of the Protocol of Provisional Application of the GATT and waivers granted under Article XXV of the GATT.

147. This paragraph, the United States points out, makes no reference to "agreements negotiated under the GATT". If the Parties had intended to include agreements negotiated under the Uruguay Round within the ambit of FTA Article 710, the United States argues, they would have made reference to these agreements in this understanding. The fact that they did not do so indicates that they did not intend to bring WTO agreements into the NAFTA.

148. The Panel does not find this argument persuasive. NAFTA Annex 702.1(4) can only be viewed as having been included to provide greater certainty. It clarifies FTA Article 710 by mentioning explicitly the GATT PPA exemptions and the GATT waivers that were not referred to in the text of FTA Article 710 itself, thereby overcoming any possible inference that FTA Article 710, which explicitly refers to GATT Article XI, might otherwise omit those exemptions and waivers. Moreover, the language of NAFTA Annex 702.1(4) appears to be inclusive not exclusive. Thus, the Panel would require more explicit evidence of the intention of

the Parties to be convinced that NAFTA Annex 702.1(4) changed the meaning of FTA Article 710 or somehow narrowed its scope.

149. The Panel is also unable to find in the general circumstances of the conclusion of the NAFTA anything that would assist in the interpretation of FTA Article 710 as a NAFTA provision. Quite clearly, the Parties used different words in the NAFTA when referring to agreements negotiated under the Uruguay Round than were used in the FTA. In particular, the term "successor agreement" was used frequently as a drafting device in the NAFTA, although it was not so used in the FTA. In the United States view, failure to use such terminology, or to use the terminology of "tariffication" on the incorporation of FTA Article 710 into the NAFTA, when such terms were used elsewhere in NAFTA Chapter Seven, is indicative of the Parties' intention. Canada argues that the Parties intended simply to incorporate into the NAFTA what they had already agreed to under the FTA in respect of agriculture. Since, in the Canadian view, FTA Article 710 as drafted was already "forward-looking" there was no need for additional wording to be included in the NAFTA text.

150. The Panel does not regard the failure of the Parties, when incorporating FTA Article 710 into the NAFTA, to amend it to include words such as "successor agreements" or "tariffication", to be a compelling consideration. The absence of such terms is most striking when the relationship between FTA Article 710 and NAFTA Article 309<sup>122</sup> is considered. Both cover agricultural non-tariff barriers but NAFTA Article 309 refers expressly to "successor agreements" while FTA Article 710 does not. It is unlikely, in the Panel's view, that the one provision (NAFTA Article 309) was intended to be prospective and the other (FTA Article 710) was intended to be static.<sup>123</sup> But the fact that these provisions have been worded differently does not mean that they are different in effect. If the words of FTA Article 710 were not capable of applying to the future, then additional wording relating to successor agreements or tariffication would have been necessary, and their absence would have been revealing. However, as the Panel has already pointed out, the wording of FTA Article 710 is just as capable of being forward-looking as it is of referring only to existing rights and obligations. Although the Parties could have reworded FTA Article 710 to make it conform more closely to the terminology of the NAFTA, there was no need to do so. FTA Article 710 simply retained the prospective effect in the NAFTA that it had had in

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<sup>122</sup> See paragraph 43 *supra*.

<sup>123</sup> As the Panel has already noted, the drafting device "successor agreements" was used throughout the NAFTA. In addition to NAFTA Article 309, see, for example, NAFTA Article 2005 where the same "successor agreement" drafting device was employed with respect to dispute resolution mechanisms whereas in the equally forward-looking FTA equivalent (FTA Article 1802 previously discussed) it was not.

the FTA.

151. The Panel is also referred to practice of the Parties in the context of the Uruguay Round. In particular, Canada emphasizes the United States own adoption of tariffs on over-quota imports of agricultural products and their application to Canada - a position seemingly at variance with that being advanced by the United States under the NAFTA against Canadian over-quota tariffs applying to the United States.

152. The Panel notes that even before Canada indicated that it was going to tariffy, the United States had submitted draft schedules to the Uruguay Round under which it was apparent that the United States would apply over quota tariffs to Canada in respect of certain products. Moreover, the United States made no objection to the Canadian tariff schedule filed under the *WTO Agreement on Agriculture*. In neither instance did the United States reserve its position with respect to the interpretation of FTA Article 710 or make it clear that its actions were "without prejudice" in respect of its disagreement with Canada over the effect of NAFTA Article 302(1). However, the Panel also notes that the United States explains that its conduct in establishing over-quota tariffs was a response to action taken by Canada. The Panel observes as well that all of this conduct occurred after 1991 by which time the Parties had identified a difference between them over the consequences of tariffication for their rights and obligations under the NAFTA.

153. The United States points out that Canada had made proposals to it for an agreement that would provide formally for tariffication under the *WTO Agreement on Agriculture* to be brought within the framework of the NAFTA and considers that the rejection of these proposals precludes the Panel from endorsing the Canadian interpretation of FTA Article 710. However, the Panel does not regard such actions by themselves as establishing the validity of the United States position. In the *Qatar v. Bahrain* case, the International Court of Justice pointed out that the rejection in negotiations of a form of words corresponding to the position asserted by one party did not imply that the thesis of the other party had to be upheld.<sup>124</sup> Moreover, the proposals for a negotiated settlement, to which the United States refers, occurred after it became clear that the Parties differed in their interpretation of FTA Article 710 and were seeking to resolve this difference through political rather than legal means.

154. Accordingly, the Panel finds nothing in the circumstances of the incorporation of FTA Article 710 into

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<sup>124</sup> *ICJ Reports 1995*, p.6, at p.22, para.41.

the NAFTA to alter the conclusion that the intention of the Parties was that FTA Article 710 was not limited in its application to the GATT and agreements negotiated under the GATT as they existed at the time that the FTA or the NAFTA entered into force.

*(iii) The consequences of the respective interpretations of FTA Article 710*

155. The question to which the Panel must now turn is whether other considerations confirm or contradict the interpretations of FTA Article 710 proposed by either Party. The question is whether the consequences that would attach to these interpretations throw any light on the Panel's inquiry into whether or not FTA Article 710 is "forward-looking".

156. Both Parties assert that the interpretation advanced by the other leads to a result that is "illogical" or "unreasonable" or "absurd". The United States argues that it would not have agreed in advance to obligations the content of which it could not anticipate. Canada refers to the "inherent absurdity of freezing in 1989 a set of obligations that was about to become obsolete".<sup>125</sup> Canada also argues that the United States position places in conflict two agreements, the NAFTA and the *WTO Agreement on Agriculture*, that should "operate in harmony".<sup>126</sup>

157. The implication of the Canadian argument that FTA Article 710 is forward-looking is that the rights and obligations deriving from the Uruguay Round agreements, including even those that replace the rights and obligations that FTA Article 710 preserved, are part of the NAFTA. This would mean that the right to maintain agricultural non-tariff barriers would be replaced by an obligation to remove non-tariff barriers. Although, as the Panel points out in the next section, this carries with it the right to replace these non-tariff barriers with tariff equivalents, the result nonetheless is more trade liberalizing than the continuation of the right to maintain non-tariff barriers. Tariffication contributes to transparency, one of the principles cited in NAFTA Article 102 when setting out the objectives of the Agreement.<sup>127</sup> As the July 1989 U.S. Tariffication Paper provides:

Tariffs are the least trade-distortive type of import barrier. They establish a direct link between

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<sup>125</sup> Second Submission of Canada, at para.42.

<sup>126</sup> Counter-Submission of Canada, at para.115.

<sup>127</sup> See note 108 *supra*.

domestic and world market prices and allow the transmission of world market signals. ...  
[T]ariffs are more transparent than non-tariff barriers. This transparency tends to promote trade  
...<sup>128</sup>

158. The implication of the United States argument that FTA Article 710 is not forward-looking is that, regardless of the outcome of the Uruguay Round, Canada and the United States would remain bound, by virtue of FTA Article 710, by their pre-existing GATT rights and obligations. The subsequent abolition of those rights among WTO members as a result of the Uruguay Round could have no effect on the obligations of Canada and the United States under the NAFTA. As a result, GATT Article XI exceptions, as well as the GATT PPA exemptions and GATT waivers in respect of agriculture, as they existed in 1994, would still exist in the NAFTA notwithstanding their elimination under the *WTO Agreement on Agriculture*.

159. The United States accepts that Canada is obliged under the *WTO Agreement on Agriculture* to eliminate non-tariff barriers. At the same time, the United States argues that Canada's over-quota tariffs, established in accordance with tariffication under the *WTO Agreement on Agriculture*, violate its NAFTA obligations. But the United States does not address directly the fact that the effect of limiting the application of FTA Article 710 to GATT rights and obligations existing at the time the NAFTA came into effect is to preserve the rights of both Parties to maintain agricultural quotas as between themselves.

160. In this regard, there appears to the Panel to be an unresolved inconsistency in the United States position. The United States has argued that Canada "gambled" that it could convince participants in the Uruguay Round to preserve the right to maintain agricultural quotas. But, if FTA Article 710 had frozen GATT rights and obligations as of 1989 or 1994, then there can have been no "gamble" by Canada at least in relation to the United States. Whether or not GATT Article XI was modified under the Uruguay Round to Canada's satisfaction, Canada would still have had the right under the NAFTA, by virtue of a "frozen-in-time" FTA Article 710, to continue with quotas. The "frozen-in-time" theory preserves GATT Article XI in its pre-Uruguay Round version as between Canada and the United States.

161. In the Panel's view, if FTA Article 710 incorporated into the NAFTA rights and obligations under the

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<sup>128</sup> July 1989 U.S. Tariffication Paper, see paragraph 29, note 19 *supra*, at para.28.



GATT that were frozen as of the date the NAFTA came into effect, then GATT Article XI, which permits certain agricultural quotas, as well as the GATT PPA exemptions and GATT waivers, would still remain in force under the NAFTA as between Canada and the United States. This would mean that the Parties' rights and obligations in respect of agricultural trade would be different from those applying between other WTO Members.

162. The difficulty with the frozen-in-time theory is that nothing in the record indicates any intention by either Party to preserve agricultural quotas under the NAFTA regardless of the outcome of the Uruguay Round. To the contrary, various statements by United States officials in 1988 following the conclusion of the FTA contemplated that these issues would be dealt with in the Uruguay Round. For example, the United States Trade Representative said to the Subcommittee on Trade of the House Committee on Ways and Means, on February 9, 1988:

The Canadians will not eliminate their quota program on eggs and egg products. It will continue in effect, just as will some of our agricultural programs, dairy for example. ... We do have an opportunity to remove the quotas in the Uruguay round and we did deliberately leave a lot of these agricultural issues for the Uruguay round because they are global issues, rather than bilateral ones.<sup>129</sup>

163. A few months later, the Deputy United States Trade Representative said to the Senate Committee on Governmental Affairs:

We did not get everything that we wanted with respect to the agricultural negotiations. For the most part, we concluded that it made sense to push those issues off to the Uruguay Round.<sup>130</sup>

164. There was no suggestion that, regardless of the results of the Uruguay Round, agricultural non-tariff barrier protection was to be preserved in the NAFTA. Significantly, the United States was consistently a proponent of the conversion of quotas into tariffs. Indeed, in the NAFTA negotiations the United States made it clear that it wanted Canada to tariffy.

165. Canada had initially hoped to maintain or modify quotas within the context of the Uruguay Round. But,

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<sup>129</sup> *United States-Canada Free Trade Agreement: Hearings Before the Subcomm. On Trade of the House Comm. On Ways and Means*, 100th Cong., 2d Sess. 56 (1988) (statement of the Hon. Clayton Yuetter, U.S. Trade Representative, February 9, 1988).

<sup>130</sup> *United States-Canada Free Trade Agreement: Hearing Before the Senate Comm. On Governmental Affairs* 100th Cong., 2d Sess 9(1988) (testimony of Ambassador Alan Holmer, Deputy U.S. Trade Representative, May 9, 1988).

there is nothing in the record to indicate that Canada sought to preserve quotas under the NAFTA regardless of what happened at the multilateral level. No doubt, it would have come as a surprise to their multilateral negotiating partners to discover that all along the United States and Canada intended to preserve agricultural quotas between themselves regardless of the outcome of the Uruguay Round.

166. The Uruguay Round negotiations began shortly after the United States and Canada commenced their negotiations on the FTA.<sup>131</sup> The Parties expressly referred to the Uruguay Round in FTA Article 701(1). They understood that, if the Round was successful, new agreements would result, just as new agreements had resulted from the Tokyo Round. In this context, "agreements negotiated under the GATT" would hardly have been viewed as a static expression, one that fixed rights in time. Thus, the interpretation of FTA Article 710 (as incorporated into the NAFTA) most in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose is that the Parties intended their rights and obligations under the FTA and subsequently under the NAFTA not to be limited to those rights and obligations under agreements existing at the time the FTA and then the NAFTA were negotiated.

167. Moreover, to adopt the approach of the United States would be to endorse an interpretation of FTA Article 710 that does not further the NAFTA objective of trade liberalization. Tariffication was an important development in the process of liberalizing trade in agriculture. As pointed out in the July 1989 U.S. Tariffication Paper, tariffication was "the logical first step in the reduction in agricultural protection". For the Panel to opt for an interpretation that turns the clock back to agricultural quotas as between Canada and the United States is a step that should be taken only in the face of clear and convincing evidence. The Panel cannot find such evidence and is not convinced that the Parties had any such common intention.

**(b) *The substantive application of FTA Article 710***

168. Having determined that FTA Article 710 is prospective in nature, the Panel must now consider what particular "rights and obligations with respect to agricultural, food, beverage and certain related goods" arising from the Uruguay Round agreements were in fact brought into the NAFTA by FTA Article 710. Canada argues that it is required by virtue of the *WTO Agreement on Agriculture* to establish tariff equivalents in place of its agricultural quotas. This obligation, in Canada's view, is found implicitly in Article 4.2 of the *WTO Agreement*

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<sup>131</sup> See paragraphs 28 and 31-34 *supra*.

on Agriculture, "but even more explicitly in the *Modalities* document".<sup>132</sup> In Canada's view, "the only way to make sense of the language of Article 4.2" is to treat tariffication as a "genuine requirement".<sup>133</sup> FTA Article 710, Canada claims, makes this obligation to tariffify part of the NAFTA.

169. The United States denies that the *WTO Agreement on Agriculture* creates any such obligation or requirement. The establishment of tariff equivalents was an option available to states - it was a "facility" not a "requirement".<sup>134</sup> The *WTO Agreement on Agriculture* created an obligation to eliminate non-tariff barriers. The reference in Article 4.2 of the *WTO Agreement on Agriculture* to "measures of the kind which have been required to be converted into ordinary customs duties" is, in the view of the United States, simply "poorly worded".<sup>135</sup> The replacement of these non-tariff barriers with tariff equivalents was something states were free to do if they wished. But, the United States argues, Canada having chosen the option of establishing tariff equivalents, that was admittedly available to it in the multilateral arena, is now subject to its NAFTA obligation not to increase or to introduce new tariffs.

170. Although the Parties differ over whether the *WTO Agreement on Agriculture* is an "agreement negotiated under the GATT" for the purposes of FTA Article 710, in the Panel's view the position is clear. By the *Punta del Este Declaration* launching the Uruguay Round the CONTRACTING PARTIES decided to enter into multilateral trade negotiations "within the framework and under the aegis of the General Agreement on Tariffs and Trade". The *Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994* ("Marrakesh Protocol"), agreed in the context of the adoption and signature of the Final Act concluding the Uruguay Round, described the negotiations as having been carried out "within the framework of GATT 1947". Clearly, the *WTO Agreement on Agriculture* and the other agreements resulting from the Uruguay Round are "agreements negotiated under the GATT".

(i) *The concept of "tariffication" under the WTO Agreement on Agriculture*

171. Much of the discussion before the Panel on the question of "tariffication" is concerned with the issue

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<sup>132</sup> Second Submission of Canada, at para.63.

<sup>133</sup> *Ibid.*

<sup>134</sup> Oral Submission of the United States, Transcript, at pp.277-278.

<sup>135</sup> Supplementary Written Submission of the United States, at para.78.

whether the *WTO Agreement on Agriculture* imposed an obligation to tariffy. Canada argues that it did; the United States denies this. The point of difficulty arises because of the language of Article 4.2 of the *WTO Agreement on Agriculture*: "Members shall not maintain, resort to, or revert to any measures of the kind which have been required to be converted into ordinary customs duties, except as otherwise provided for in Article 5 and Annex 5" (emphasis added). Did these words create an obligation to tariffy? In the Panel's view, taken by themselves, or even in conjunction with the rest of the *WTO Agreement on Agriculture*, they did not. Clearly, however, the words emphasized in the quotation above suggest that there did exist separately from Article 4.2 a provision containing an antecedent obligation to tariffy.

172. Since as a matter of general principle some meaning must be attributed to the words in Article 4.2 of the *WTO Agreement on Agriculture*, it becomes necessary to look beyond the text of the provision to its context, to any subsequent agreement or practice of the parties and, if necessary, to supplementary means of interpretation such as the *travaux préparatoires* of the *WTO Agreement on Agriculture* and the circumstances of its conclusion more generally. This approach is expressly contemplated by Vienna Convention Articles 31 and 32.<sup>136</sup>

173. The starting point of this analysis must be the negotiations constituting the Uruguay Round. The objective of the negotiations in relation to agricultural trade as set out in the *Punta del Este Declaration* was to:

- ... achieve greater liberalization of trade in agriculture ... by:
- (i) improving market access through, *inter alia*, the reduction of import barriers;
- ...

174. The mechanism for achieving this, as first proposed by the United States in 1988, was the conversion of non-tariff barriers to "tariff equivalents", a process known as "tariffication". The essence of tariffication was that states were required to eliminate their agricultural non-tariff barriers and were permitted to establish tariff-rate quotas in their place.

175. The United States tariffication proposal formed the basis of subsequent discussion in the Negotiating Group on Agriculture. Thus, the Chairman of this Group circulated a draft text of a *Framework Agreement on Agricultural Reform Programme* on July 11, 1990 which provided, *inter alia*, for the "conversion of all border

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<sup>136</sup> See note 106 *supra*.

measures other than normal customs duties into tariff equivalents".<sup>137</sup>

176. This formulation was later reflected in the Dunkel Draft<sup>138</sup> submitted to the Uruguay Round participants on December 20, 1991. This contained, in Part B of the draft "Text on Agriculture", a section entitled "Agreement on Modalities for the Establishment of Specific Binding Commitments under the Reform Programme" which set out the modalities to be adopted for tariffication. Annex 3 of this draft, in paragraph 3, provided that "[t]ariff equivalents shall be established for all agricultural products subject to border measures other than ordinary customs duties ..." (emphasis added).

177. These tariffication modalities were subsequently issued separately by the Chairman of the Market Access Group on December 20, 1993 - under the heading "Modalities for the Establishment of Specific Binding Commitments under the Reform Programme"<sup>139</sup> - as a guide to states in the preparation of their tariff schedules. Annex 3 of the Modalities Document reproduced, in paragraph 3, the provision first set out in the Dunkel Draft, viz. "[t]ariff equivalents shall be established for all agricultural products subject to border measures other than ordinary customs duties ..." (emphasis added).

178. Both the Dunkel Draft and the Modalities Document thus contained mandatory language - "[t]ariff equivalents shall be established ..." (emphasis added). This language did not, however, find its way into Article 4.2 of the *WTO Agreement on Agriculture*.

179. In the Panel's view, the Dunkel Draft, the Modalities Document, and the documents on which they were based, may properly be taken into account when interpreting the *WTO Agreement on Agriculture*. They form part of the *travaux préparatoires* and circumstances of the conclusion of the *WTO Agreement on Agriculture* to which reference may be made pursuant to Vienna Convention Article 32. In this regard, the Panel observes that the obscurity of the meaning of Article 4.2 of the *WTO Agreement on Agriculture* justifies recourse to such supplementary material for purposes of interpretation. The Panel also considers that the Modalities Document may be regarded as part of the context of the *WTO Agreement on Agriculture* for the purposes of interpretation pursuant to Vienna Convention Article 31(2) and, furthermore, that the practice of states in tariffing their non-

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<sup>137</sup> GATT Document MTN.GNG/NG5/W/170; at para.12.

<sup>138</sup> See paragraph 35 *supra*.

<sup>139</sup> See paragraph 36 *supra*.

tariff barriers on becoming WTO members could be regarded as "subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation" within the meaning of Vienna Convention Article 31(3)(b). In the light of its observations regarding recourse to the material in question pursuant to Vienna Convention Article 32, the Panel does not, however, consider it necessary to rule definitively on these points.

180. What is evident from the record of the Uruguay Round negotiations on agriculture set out above is: (a) the commitment of states to remove their non-tariff barriers to imports of agricultural products, (b) as the *quid pro quo* for the removal of the non-tariff barriers, the right of states to establish tariff equivalents (at rates not exceeding the level of protection provided by the non-tariff barriers they replaced), and (c) the expectation that such tariff equivalents would in fact be established. The certainty of this expectation, affirmed by the practice of WTO Members, is reflected, albeit rather obscurely, in the language of Article 4.2 of the *WTO Agreement on Agriculture*.

181. In the light of the *quid pro quo* evident in the agreement to remove non-tariff barriers, the entitlement to establish and apply tariff equivalents was, in the minds of the participants, inextricably linked with the obligation to remove non-tariff barriers. While an entitlement to establish and apply tariff equivalents is not the same as an obligation to do so, there were nevertheless several elements of obligation involved in this entitlement. States wishing to replace their non-tariff barriers with another form of protection had an obligation to tariffify. No other form of protection would have been permissible. Furthermore, the level of that protection could not in principle exceed the level of protection afforded by the non-tariff barrier it replaced. In other words, states had an obligation to convert their non-tariff barriers in the sense that those barriers had to be removed. This analysis does not, however, exclude the possibility that the obligation to convert would have been satisfied by the removal of those barriers without replacing them with any form of tariff. In short, it seems to the Panel that the wording of Article 4.2 of the *WTO Agreement on Agriculture* is nothing more than an imprecise method of referring to a complex of rights and obligations by which non-tariff barriers were replaced with tariffs.

182. In any event, whether or not tariffication is viewed as the discharge of an obligation (as appears to have been the principal ground on which Canada has based its comments before the Panel), in the Panel's view it is the exercise of a right arising from an agreement negotiated under the GATT.

183. In this connection, it is once again necessary to go back to the beginning of the Uruguay Round.

Liberalization in agricultural trade, as the *Punta del Este Declaration* makes clear, required the reduction of import barriers. This was to be achieved by the elimination of non-tariff barriers. States, nevertheless, had the right to establish "tariff equivalents" in place of these non-tariff barriers. In other words, they were entitled to equivalent protection through the establishment of over-quota tariffs. This, indeed, is expressly acknowledged by the United States in its *Statement of Administrative Action* on the implementation of the Uruguay Round Agreements into United States law:

This [tariffication] means that they [states] will replace their non-tariff barriers with tariffs set at rates that will provide trade protection equivalent to the protection provided during the base period by the non-tariff barriers. (Emphasis added)<sup>140</sup>

184. The very words widely used to describe these measures of equivalent protection - "tariff equivalents" - clearly indicate their *raison d'être*.

185. Thus, in the Panel's view, an examination of the course of the negotiations on agriculture in the Uruguay Round as evidenced by the Dunkel Draft and the Modalities Document leads to the conclusion that the arrangement under which agricultural non-tariff barriers were eliminated rested on a simple bargain. States agreed to eliminate their non-tariff barriers as the *quid pro quo* for the right to replace them with "tariff equivalents". That is, they were replacing protection in the form of quotas or other non-tariff barriers with protection in the form of tariffs. This right to establish such tariffs was also subject to certain reduction and volume commitments,<sup>141</sup> including a commitment to phase those tariffs down over time.

186. It was pointed out to the Panel at an advanced stage in the proceedings that some of the tariffs in dispute may not have replaced pre-existing non-tariff barriers. This, it was suggested, would be incompatible with the idea that tariffication involved the replacement of non-tariff barriers with tariff equivalents. In light of the conclusions reached below, the Panel does not find it necessary to determine whether the tariffs in question did or did not replace non-tariff barriers.

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<sup>140</sup> *Uruguay Round Trade Agreements, Message from the President of the United States Transmitting The Uruguay Round Trade Agreements, Texts of Agreements Implementing Bill, Statement of Administrative Action and Required Supporting Statements*, H.R. Doc. 103-316, Vol. 1, 103d Cong., 2d Sess., at p.711 (p.55, Statement of Administrative Action).

<sup>141</sup> These commitments are reflected in the Tariff Schedules of Members annexed to GATT 1994.

187. In the Panel's view there is a need to distinguish between the theory of tariffication, that is the replacement of non-tariff barriers with tariff equivalents established in strict conformity with agreed formulae, and tariffication as it actually occurred in the Uruguay Round. In practice, tariffication included the creation of tariffs where there was no direct equivalency with a prior non-tariff barrier. As both Parties acknowledged in the course of these proceedings, the actual implementation of tariffication varied widely.<sup>142</sup> That some latitude could be exercised by states in this regard is reflected in the covering note to the Modalities Document which provided that the "negotiating modalities shall not be used as a basis for dispute settlement proceedings under the MTO Agreement".<sup>143</sup> The basic obligation to remove non-tariff barriers was, however, strictly adhered to. No such barriers were permitted to remain.

188. In practice, therefore, tariffication has to be understood as a "package" in which the goal of the elimination of non-tariff barriers was to be achieved by allowing states some leeway in the setting of the tariff regime that replaced their previously existing regimes of non-tariff barriers. The culmination of tariffication was the entry into force of the *WTO Agreement on Agriculture* and of the tariff schedules annexed to GATT 1994. The filing of tariff schedules was an essential step in becoming a Member of the WTO and thereby a party to the *WTO Agreement on Agriculture* and GATT 1994. Tariff schedules were prepared on this basis and submitted in February 1994 for examination by all Uruguay Round participants. The schedules were annexed to the *Marrakesh Protocol* which was signed on April 15, 1994. On the entry into force of the WTO Agreement in January 1, 1995 tariff schedules annexed to the *Marrakesh Protocol* became schedules to GATT 1994.

189. These instruments crystallised the arrangement for the elimination of non-tariff barriers, and they constitute the binding agreement of WTO members with respect to the items included and the tariffs resulting from tariffication. This was the package accepted by both Canada and the United States when they became parties to the WTO. There is, in the Panel's view, no basis for going behind this agreement and questioning the tariffs included in Canada's WTO tariff schedule.

190. The preceding paragraphs demonstrate that in the context of the Uruguay Round states acquired a right

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<sup>142</sup> Thus, the United States noted: "[t]he negotiating parties in the Uruguay Round did not agree on the text of the Modalities and many parties departed from its provisions in preparing their Schedules." (Supplementary Written Submissions of the United States, at para.78, note 47). In the course of the hearing, counsel for Canada observed: "Article 4.2 [of the *WTO Agreement on Agriculture*] operates as a general amnesty; basically, it says that we will disregard, we will set aside the question of whether these measures were compatible with the Agreement in the first place and we will tariffy them in any event." (Transcript, at p.353.).

<sup>143</sup> See note 23 *supra.*, at p.1, para.4.



to establish tariff equivalents in place of their non-tariff barriers, and that following the entry into force of the WTO Agreement more specific rights and obligations arising out of tariffication emerged. These were the obligation under the *WTO Agreement on Agriculture* not to "maintain, resort to, or revert to" agricultural non-tariff barriers, and the right to apply the tariffs resulting from tariffication to agricultural products on the terms set out in each state's tariff schedule. The extent to which these "rights and obligations" are brought into the NAFTA by FTA Article 710 will now be considered by the Panel.

*(ii) The content of the "rights and obligations" incorporated by FTA Article 710*

191. In light of this analysis of the rights and obligations of the Parties in respect of tariffication, the Panel must now consider the effect of FTA Article 710 as incorporated into the NAFTA. Canada argues that its effect is to incorporate into the NAFTA the "tariff equivalents that function as direct replacements for the non-tariff measures" that have now been eliminated.<sup>144</sup>

192. The United States argues that even if FTA Article 710 is forward-looking, it does not incorporate tariffs into the NAFTA. The United States also contends that, in any event, WTO tariffs are not exceptions to NAFTA tariffs. It takes the view that, following Canada's reasoning, the entire NAFTA schedule for agricultural, food, beverage and certain related products would be replaced by the WTO tariff schedules. In the view of the United States, the distinction between tariff and non-tariff barriers has been reflected carefully in the NAFTA. NAFTA Article 302(1) focuses on tariffs. FTA Article 710 focuses on non-tariff barriers.

193. The Panel is not persuaded that FTA Article 710 is limited in application to non-tariff barriers. FTA Chapter Seven is not restricted exclusively to non-tariff barriers. FTA Article 702 permits a Party, subject to certain conditions, to impose a temporary duty on fresh fruits and vegetables originating in the territory of the other Party. Nor is NAFTA Chapter Seven limited to non-tariff barriers. Section A of NAFTA Chapter Seven applies to "measures adopted or maintained by a Party relating to agricultural trade".<sup>145</sup> A "measure", according to NAFTA Article 201(1), includes any "law, regulation, procedure, requirement or practice". Clearly it is not limited to non-tariff barriers; it can extend to tariffs. Moreover, NAFTA Article 703, the title of which is "Market Access", contains provisions relating to tariffs. The concept of "market access" in NAFTA Chapter Seven covers

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<sup>144</sup> Second Submission of Canada, at para.24.

<sup>145</sup> See NAFTA Article 701(1), paragraph 44 *supra*.

both tariff and non-tariff barriers.

194. The wording of FTA Article 710 itself supports the view that it is not limited to non-tariff barriers. The article refers to rights and obligations under the GATT and agreements negotiated under the GATT "including ... rights and obligations under GATT Article XI". This suggests that the reference to non-tariff barriers (GATT Article XI) is in addition to other rights and obligations. It does not suggest that FTA Article 710 is limited to non-tariff barriers.

195. Thus, neither the FTA nor the NAFTA contains any prohibition against FTA Article 710 applying to both tariff and non-tariff measures. Whether FTA Article 710 applies to particular tariffs cannot be answered in the abstract. The question in the present circumstances is whether it applies to the tariffs established through tariffication under the *WTO Agreement on Agriculture*.

196. In determining the content of FTA Article 710, the Panel is conscious of the need to ensure that the article not be used as a basis for defeating the objectives of the NAFTA as a free trade agreement. The particular character of a free trade agreement is that it provides special rules applicable to trade between its parties that may differ from those applicable multilaterally. Thus, FTA Article 710 could not have been intended to provide for the wholesale incorporation of GATT rights and obligations relating to agricultural products. In this respect, the Panel accepts the United States argument that FTA Article 710 cannot be interpreted to provide for the simple substitution of the WTO tariff schedule for the NAFTA tariff schedule.

197. In the Panel's view, an important objective of FTA Article 710 both in the FTA and carried over into the NAFTA was to preserve for both Parties the agricultural protection permitted by the GATT, including GATT Article XI agricultural quotas, GATT PPA exemptions and GATT waivers. It is true that the primary purpose of GATT Article XI is to eliminate quantitative restrictions, but it is on the exceptions to such elimination that Canada and the United States appear to have focused in both the FTA and the NAFTA. This is made clear by the wording of FTA Article 710 itself which refers expressly to GATT Article XI and by the understanding of the Parties set out in NAFTA Annex 702.1(4) in which GATT PPA exemptions and GATT waivers are mentioned specifically as being included in FTA Article 710. By accepting the application of GATT rights and obligations, including those under agreements negotiated under the GATT, the Parties were also accepting any modifications that might be made to the regimes under the GATT that permitted agricultural protection.

198. The question, then, is what is the nature of the change made as a result of the Uruguay Round to the right to maintain agricultural non-tariff barriers? The United States argues that the change was the elimination of these barriers. The fact that they were turned into tariffs is, in a sense, incidental. But, as the Panel has already pointed out, the right to tariffify was granted in exchange for the obligation to eliminate non-tariff barriers. This was all part of a "package" on agricultural trade. To bring into the NAFTA only the obligation to eliminate non-tariff barriers without the *quid pro quo* for their elimination would ignore the agreement that made the elimination of non-tariff barriers acceptable. Even more important, it would ignore the fact that WTO Members have the right to apply the tariffs on agricultural products set out in their tariff schedules annexed to the GATT 1994.

199. The Panel concludes, therefore, that FTA Article 710 brings into the NAFTA, as between Canada and the United States, the rights and obligations under the Uruguay Round agreements that replaced those rights and obligations under which agricultural quotas were maintained. These rights and obligations brought into the NAFTA include:

- (a) the obligation not to "maintain, resort to, or revert to" non-tariff barriers to agricultural trade of the kind that have been converted to tariffs, as required by Article 4.2 of the *WTO Agreement on Agriculture* and subject to the exceptions therein provided;
- (b) the right to apply the tariffs that resulted from tariffication, as set out in their respective tariff schedules, to over-quota imports of agricultural products; and
- (c) the obligation to reduce these tariffs and to ensure minimum volumes of imports as provided in the Parties' WTO Tariff Schedules.

200. The Panel notes that the incorporation into the NAFTA of the WTO tariffs that replaced the non-tariff barrier regime in respect of imports of agricultural products raises a question about market access obligations set out in FTA Articles 704, 705 and 706 which were obviously drafted with non-tariff barriers in mind. However, the Panel notes Canada's statement to the Panel that in establishing its over-quota tariffs it had taken account of those provisions, treating them as if they applied equally to such tariffs.

201. Thus, in the Panel's view, FTA Article 710 does not mandate the wholesale bringing into the NAFTA of GATT, and now of WTO, rights and obligations; it allows only for the incorporation of those tariffs that

resulted from tariffication. In other words, in respect of products formerly subject to quotas, the result is that in-quota tariffs applying between the United States and Canada in respect of agricultural products are those established under the NAFTA, and tariffs on over-quota imports are those established in the WTO tariff schedules. WTO in-quota rates do not come into the NAFTA; they were not part of the tariffication *quid pro quo*. FTA Article 710, in the Panel's view, does not provide for the unlimited incorporation of GATT "rights and obligations" into the NAFTA.

(c) *The relationship between NAFTA Chapters Three and Seven*

202. The United States argues that NAFTA Article 302(1) poses a barrier to Canada's over-quota tariffs on imports of agricultural goods. It provides a clear prohibition on increasing customs duties or adopting new duties. Although NAFTA Article 302(1) is subject to exceptions, these are, according to the United States, limited to those circumstances where exceptions are specifically provided for. No exception is provided in respect of FTA Article 710.

203. Canada argues that NAFTA Article 302(1) is on its face subject to other parts of the NAFTA. This is recognized in the opening words of the article, "[e]xcept as otherwise provided in this Agreement ...." Moreover, NAFTA Chapter Seven, which deals with the specific area of agriculture, provides at the outset in NAFTA Article 701(2) that "[i]n the event of any inconsistency between this Section and another provision of this Agreement, this Section shall prevail to the extent of the inconsistency". On this basis, Canada argues that "with respect to agricultural goods, Chapter Seven is paramount as between these two chapters".<sup>146</sup>

204. The Panel accepts that the obligations set out in NAFTA Article 302(1) can be subject to exceptions. This is clear from the opening words of paragraph 1 of the article. It is also made clear in NAFTA Article 300 which deals with the "[s]cope and [c]overage" of that Chapter. NAFTA Article 300 provides:

This Chapter applies to trade in goods of a Party, including:

...

(c) goods covered by another Chapter in this Part, except as provided in such ... Chapter.

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<sup>146</sup> Oral Submission of Canada, Transcript, at p.94.

205. In addition, the assertion of the primacy of NAFTA Chapter Seven in the event of an inconsistency suggests that there will be circumstances where a conflict between NAFTA Chapters Seven and Three would be resolved in favour of NAFTA Chapter Seven.

206. The United States argument that NAFTA Article 302 is not subject to the provisions of FTA Article 710 is based on its view that NAFTA Article 302 applies to tariffs and FTA Article 710 to non-tariff barriers. The Panel has already rejected this distinction, and this undermines the force of the United States argument on this issue.

207. As already pointed out, the effect of FTA Article 710 is to incorporate into the NAFTA, *inter alia*, the obligation on the Parties to remove agricultural non-tariff barriers and the right to replace those non-tariff barriers with the over-quota tariffs set out in their tariff schedules. But NAFTA Article 302(1) provides a clear prohibition on increasing existing, or adopting new, customs duties. Thus, the creation of over-quota tariffs on the import of products at rates higher than the NAFTA rates for in-quota imports of such products results in an inconsistency between FTA Article 710 and the obligations under NAFTA Article 302(1). In these circumstances, the Panel concludes, NAFTA Article 701(2) applies. There is an "inconsistency between this Section [Section A of Chapter Seven] and another provision of this Agreement". In that event, according to NAFTA Article 701(2), "this Section shall prevail to the extent of the inconsistency". Thus, FTA Article 710 must prevail.

### **C. Conclusion**

208. The Panel decides that FTA Article 710 has the effect of bringing into the NAFTA the replacement regime for agricultural non-tariff barriers that was established under the WTO. This consists of an obligation not to introduce or maintain such non-tariff barriers and the right to apply the tariffs that resulted from tariffication, as set out in their tariff schedules, to over-quota imports of agricultural products, together with the obligation to reduce those tariffs and ensure certain minimum volumes of imports. These rights are not diminished by NAFTA Article 302(1).

### **(2) Determination**

209. In light of the above analysis and conclusions, the Panel determines that the application of customs duties

by the Government of Canada to the U.S.-origin products specified in the enclosure to the July 10, 1995 letter of the United States Trade Representative, Michael Kantor, to the Canadian Minister for International Trade, Roy MacLaren, conforms with the provisions of the *North American Free Trade Agreement*.

Signed in the original by:

Professor Elihu Lauterpacht, C.B.E., Q.C. (Chair)

Professor Elihu Lauterpacht, C.B.E., Q.C. (Chair)

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Dean Stephen Zamora

Dean Stephen Zamora

Submitted to the disputing Parties on December 2, 1996.