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

AB-1999-4

Report of the Appellate Body

WORLD TRADE ORGANIZATION
APPELLATE BODY

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

Canada, *Appellant*

New Zealand, *Appellee*
United States, *Appellee*

AB-1999-4

Present:

Matsushita, Presiding Member
Feliciano, Member
Lacarte-Muró, Member

I. Introduction

1. Canada appeals from certain issues of law and legal interpretations developed by the Panel in *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products* (the "Panel Report").[1] Following their requests for consultations, the United States[2] and New Zealand[3] requested that the Dispute Settlement Body (the "DSB") establish panels to examine certain alleged export subsidies that they contended Canada or its provinces had granted, through the Special Milk Classes Scheme, to support the export of dairy products and to examine a claim by the United States regarding imports into Canada of fluid milk and cream within the 64,500 tonnes tariff-rate quota committed in Canada's Schedule of Commitments under the *Marrakesh Agreement Establishing the World Trade Organization* (the "*WTO Agreement*"). On 25 March 1998, the DSB agreed to establish two panels in accordance with these requests and further agreed that the two panels would be consolidated into a single panel pursuant to Article 9.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU") with standard terms of reference.

2. The Panel considered claims made by the United States and New Zealand that Canada's measures are inconsistent with Articles II, X, XI and XIII of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994"); Articles 3, 4, 8, 9, and 10 of the *Agreement on Agriculture*; Article 3 of the *Agreement on Subsidies and Countervailing Measures* (the "*SCM Agreement*"); and Articles 1, 2 and 3 of the *Agreement on Import Licensing Procedures*. The Panel Report was

[1]WT/DS103/R, WT/DS113/R, 17 May 1999.

[2]WT/DS103/4, 2 February 1998.

[3]WT/DS113/4, 12 March 1998.

circulated to Members of the World Trade Organization (the "WTO") on 17 May 1999. In paragraph 8.1 of its Report, the Panel concluded that Canada:

> (a) through Special Milk Classes 5(d) and (e) - and this for all of the dairy products in dispute (butter, cheese and "other milk products") and for both marketing years at issue (1995/1996 and 1996/1997) - has acted inconsistently with its obligations under Article 3.3 and Article 8 of the Agreement on Agriculture by providing export subsidies as listed in Article 9.1(a) and Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule; and
>
> (b) by restricting the access to the tariff-rate quota for fluid milk to (i) consumer packaged milk for personal use and (ii) entries valued at less than C$20, acts inconsistently with its obligations under Article II:1(b) of GATT 1994.

3. In paragraph 8.3 of its Report, the Panel made the following recommendation:

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

4. On 15 July 1999, Canada notified the DSB of its intention to appeal certain issues of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the DSU, and filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "*Working Procedures*"). On 19 July 1999, Canada filed its appellant's submission.[4] On 6 August 1999, the United States and New Zealand filed their respective appellees' submissions.[5]

5. The oral hearing in the appeal was held on 6 September 1999.[6] The participants presented oral arguments and responded to questions put to them by the Members of the Appellate Body Division hearing the appeal.

[4]Pursuant to Rule 21(1) of the *Working Procedures*.

[5]Pursuant to Rule 22(1) of the *Working Procedures*.

[6]Pursuant to Rule 27 of the *Working Procedures*.

II. Background

A. *The Canadian Dairy Regime*

6. The relevant factual and regulatory aspects concerning the Canadian dairy regime, including the Special Milk Classes Scheme, are fully described in paragraphs 2.1 to 2.66 of the Panel Report. For the purposes of this appeal, we summarize certain of the principal aspects of the Panel's factual findings.

1. Institutions

7. Regulatory jurisdiction over trade in dairy products in Canada is divided between the federal and the provincial governments.[7] The Canadian federal government has the power to regulate inter-provincial and international trade generally, including trade in milk, while the provincial governments have jurisdiction over aspects of the production and sale of milk within the provinces.[8] Three entities have decision-making roles with respect to the production and sale of milk in Canada: the Canadian Dairy Commission (the "CDC"), the provincial milk marketing boards and the Canadian Milk Supply Management Committee (the "CMSMC").

(a) CDC

8. The CDC is a Crown corporation established under the Canadian Dairy Commission Act (the "CDC Act"), a federal statute.[9] The CDC is funded by the Canadian federal government as well as by its market activities and by producers.[10] The chairman, the vice-chairman and the commissioner of the CDC are appointed by the federal government of Canada, and the CDC is accountable to the federal Parliament, reporting to the Minister of Agriculture and Agri-Food.[11]

9. The CDC Act empowers the CDC, *inter alia*, to establish national target prices for industrial milk[12]; to buy and sell dairy products, including through importation and exportation; and to operate

[7]Panel Report, para. 2.7.

[8]*Ibid.*

[9]*Ibid.*, para. 2.12.

[10]*Ibid.*, para. 2.14.

[11]*Ibid.*

[12]Industrial milk includes all milk utilized in the preparation of processed dairy products, such as butter, cheese, milk powder, ice cream and yoghurt (see Section F of the National Milk Marketing Plan (the "NMMP")).

pools for the marketing of milk and cream.[13] As the chair of the CMSMC[14], the CDC participates both in the implementation of the Comprehensive Agreement on Special Class Pooling[15] and in the establishment of the annual national production quota.[16] The CDC also chairs the Advisory Group on Preemptive Surplus Removal (the "Surplus Removal Committee"), which determines when and whether there is surplus milk available for exports.[17]

(b) Provincial Milk Marketing Boards

10. In each province, a milk marketing board has been established to "[regulate] the production for marketing, or the marketing, in intraprovincial trade of any dairy product."[18] Membership of the provincial milk marketing boards is comprised mostly or exclusively of dairy producers.[19]

11. The provincial milk marketing boards operate within a legal framework established under federal and provincial legislation, and they exercise powers, given by the federal and provincial governments, in respect of the issuance and administration of quotas, the pooling of returns at the provincial level, pricing, record-keeping and reporting, inspection and agreements to cooperate with other provinces and the CDC.[20] Milk producers cannot sell milk without using the provincial milk marketing boards as an intermediary.[21] Orders or regulations issued by the provincial milk marketing boards can be enforced in the Canadian courts.[22]

(c) CMSMC

12. The CMSMC is a body established under the NMMP, a federal-provincial agreement whose purpose is to regulate the marketing of milk and cream products in Canada.[23] The NMMP is signed by nine of the provincial milk marketing boards, some provincial governments, and the CDC.[24] The CMSMC is composed of the representatives of the signatory provincial milk marketing boards and the

[13]Panel Report, para. 2.13. The CDC's powers are set out in full in this paragraph of the Panel Report.

[14]*Ibid*., para. 2.28.

[15]*Ibid*., para. 2.27.

[16]*Ibid*., para. 2.29.

[17]Section C.1(ii) of Annex B of the Comprehensive Agreement on Special Class Pooling. "Surplus milk" is milk that is surplus to Canadian domestic requirements.

[18]Panel Report, para. 2.16. The Panel quotes from Section 2 of the CDC Act.

[19]*Ibid*., para. 2.18.

[20]*Ibid*., para. 2.17.

[21]*Ibid*., para. 2.19.

[22]*Ibid*., para. 7.76.

[23]*Ibid*., para. 2.22.

[24]*Ibid*., para. 2.21.

respective provincial governments and is chaired by the CDC.[25] The Dairy Farmers of Canada, the National Dairy Council and the Consumers Association of Canada also participate in the CMSMC but have no voting rights.[26]

13. The CMSMC oversees the implementation of the Comprehensive Agreement on Special Class Pooling, pursuant to which the Special Milk Classes Scheme is established.[27] The CMSMC sets the annual national production target for industrial milk (known as the national market sharing quota, the national "MSQ").[28] The CMSMC then allocates the national MSQ among the provinces based on historical production levels.[29]

2. The Special Milk Classes Scheme

14. Industrial milk in Canada is subject to a national common classification system, under which the pricing of milk is based on the end use to which the milk is put.[30] The classification system establishes five different "Classes" of milk, the first four of which cover milk used exclusively in the domestic market.[31] The "Special Milk Classes" are the five sub-classes of Class 5 milk. Special Classes 5(a) to 5(c) cover milk used for the preparation of certain dairy products that are either sold in the domestic market or exported.[32] Special Class 5(d) is for milk used in products exported to "traditional" export markets.[33] Special Class 5(e) is for the removal of surplus milk from the domestic market.[34] Surplus milk may be either milk that is produced within production quota limits ("in-quota milk") or milk that is produced in excess of production quota limits ("over-quota milk").[35]

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[25]Panel Report, para. 2.28.

[26]*Ibid*.

[27]*Ibid*., para. 2.27.

[28]*Ibid*., para. 2.29.

[29]*Ibid*., paras. 2.29 and 2.31.

[30]*Ibid*., para. 2.38.

[31]The Panel describes Classes 1 to 4 of the classification system in paragraph 2.38 of the Panel Report.

[32]Panel Report, para. 2.39.

[33]*Ibid*. Further details as to the operation of Special Class 5(d) are given at paragraphs 2.49, 2.51, 2.53 to 2.56, 7.68 and 7.69 of the Panel Report.

[34]*Ibid*. Further details as to the operation of Special Class 5(e) are given at paragraphs 2.49, 2.51, 2.53 to 2.58 and 7.70 to 7.72 of the Panel Report.

[35]Further details regarding in-quota and over-quota milk are given at paragraphs 2.40, 2.42 to 2.46 and 2.53 to 2.58 of the Panel Report.

3. Price of Milk to the Processor

15. The price of Special Classes 5(d) and 5(e) milk is negotiated by the CDC and the processors/ exporters on a transaction-by-transaction basis.[36] The price at which industrial milk is made available under Special Classes 5(d) and 5(e) is "significantly lower" than the price of industrial milk destined for domestic use.[37] In the case of export sales of milk under Special Classes 5(d) and 5(e), processors are guaranteed a "margin" which "covers the cost of transforming milk … and a return on investment …".[38]

4. Returns to the Producer – Pooling

16. Returns to producers from the sale of milk are calculated on the basis of a system of pooling. Two separate pooling mechanisms are used to pool returns from sales of in-quota and over-quota milk. Revenues from all in-quota sales are pooled on a regional basis, whether the milk sold was destined for domestic use or for export.[39] Over-quota sales are subject to a much more limited pooling of returns that covers only over-quota sales. This pooling is conducted on a national basis.[40]

B. *Canada's Tariff-Rate Quota for Fluid Milk*

17. The factual aspects relating to Canada's tariff-rate quota for fluid milk are fully provided at paragraphs 7.142 and 7.143 of the Panel Report.

[36]Panel Report, para. 2.51.

[37]*Ibid*., para. 7.50. See also para. 2.51, Table 3, and para. 7.40 of the Panel Report.

[38]*Ibid*., para. 7.59.

[39]Further details regarding the pooling mechanism for in-quota milk are given at paragraphs 2.59 to 2.63 and 7.107 to 7.111 of the Panel Report.

[40]Further details regarding the pooling mechanism for over-quota milk are given at paragraph 7.112 of the Panel Report.

III. Arguments of the Participants

A. *Claims of Error by Canada – Appellant*

1. Article 9.1(a) of the *Agreement on Agriculture*

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

18. Canada contends that the interpretation of the term "export subsidies" in the *Agreement on Agriculture* must take into account the related provisions of the *SCM Agreement*. The *Agreement on Agriculture* and the *SCM Agreement* are both Multilateral Agreements on Trade in Goods and, in the language of Article II:2 of the *WTO Agreement*, are "integral parts" of the *WTO Agreement*. The two Agreements reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The clear inference is that, if possible, there should be consistency of interpretation between the two Agreements, particularly with respect to the notions of "subsidies" and "export subsidies". In Canada's view, the Panel did not give proper consideration to this need for consistent interpretation.

19. Canada submits that the interpretation of the expression "direct subsidies, including payments-in-kind", in Article 9.1(a) of the *Agreement on Agriculture*, should begin with the word "subsidies". That word, although not defined in the *Agreement on Agriculture*, is defined in Article 1.1 of the *SCM Agreement*. If the elements identified in Article 1.1 are present, Article 9.1(a) of the *Agreement on Agriculture* requires examination of whether the "subsidies" are "direct". The Panel erred by failing to do this. In Canada's view, a subsidy is "direct" if: it is funded directly from government funds; it is paid directly to the beneficiary by the government itself; *and* it does not involve the activities of non-governmental actors acting through a government-mandated scheme. In this case, since the alleged subsidy is not funded by government, it is not "direct".

20. The Panel also erred by "equating 'payments-in-kind' with 'direct subsidies'".[41] A subsidy may take the form of a "payment-in-kind", but a "payment-in-kind" is not necessarily a "subsidy". By collapsing these separate legal concepts, the Panel failed to address the two fundamental elements of Article 9.1(a): namely, the terms "direct" and "subsidies".

[41]Canada's appellant's submission, para. 46.

21. Canada contends that the Panel also substituted for the ordinary meaning of "payments", in the term "payments-in-kind", a special meaning of "gratuitous act, a bounty or benefit".[42] The end result is that the Panel equates "payments-in-kind" with "direct subsidies", and "payments", in "payments-in-kind", with "benefit". In so doing, the Panel has confused the *form* of a transaction ("payments-in-kind") with its *economic consequences* ("benefit").

22. Moreover, by holding that the "provision of a good at a price lower than the normal price"[43] was a "payment-in-kind", the Panel departed from the ordinary meaning of that term, which Canada sees as reflecting a requirement to show a "financial contribution". When goods are sold at less than the "normal" price, purchasers are not receiving payments-in-kind but are simply paying less for the goods they receive.

23. Although the Panel correctly set out to establish the existence of a "benefit", it misconstrued and misapplied that concept. The Panel established two "benchmarks" to test whether a benefit was conferred.[44] Canada submits that the Panel erred in relying on the domestic price of milk as the first benchmark since that price is influenced by lawful, bound tariffs. On the basis of the Panel's approach, the exportation of any product, subject to an import tariff, at the prevailing world market price is, effectively, an export subsidy. It is, however, normal commercial practice for domestic and export prices to be different. Indeed, several provisions of WTO law suggest that price differentiation on the basis of market realities is acceptable.

24. Canada notes that the Panel's "benefit" test is based on whether processors obtain milk under Special Classes 5(d) and 5(e) at a price more advantageous than the prevailing world market price for competing products, *whether or not processors choose to source the product from those markets.* The Panel's approach overlooks the commercial reasons why certain access opportunities are not pursued. The Panel was also wrong to presume that there is a "world market" price for raw milk, since raw milk is rarely traded internationally.

25. Canada states that the legal error committed in connection with the second benchmark was compounded: by a failure to take into account relevant factual considerations and by making unwarranted presumptions concerning the import of milk under the Import for Re-export Program; by engaging in unwarranted speculation about the commercial viability of importing fluid milk into Canada from the United States; and, by relying on evidence that was deemed to contain "certain

[42]Panel Report, para. 7.44.

[43]*Ibid*., para. 7.45.

[44]*Ibid*., para. 7.47.

inaccuracies"[45], without providing a basic rationale under Article 12.7 of the DSU to justify placing reliance on such evidence.

(b) "governments or their agencies"

26. Canada argues that the Panel erred by finding that the provincial milk marketing boards are government agencies "solely on the basis of one characteristic: the delegation of some governmental authority."[46] The mere fact of delegation of authority from government is not sufficient to conclude that an entity is an agency of government.

27. Canada notes that, in Article 9.1(a), marketing boards are identified as potential recipients of "direct subsidies". The implication is that a marketing board is distinct from "governments or their agencies". Moreover, if marketing boards are deemed to be "government agencies", the result would be that subsidies are being provided by a government to itself.

28. According to Canada, the Panel was misguided in relying on Article XVII of the GATT 1994 to support its conclusion that marketing boards may be government agencies. That provision has no bearing on the status of the marketing boards at issue under Article 9.1(a). Similarly, the Panel's reference to Article XXIV:12 does not advance its reasoning. That provision states that "regional" or "local" authorities are subject to GATT obligations but does not define such authorities.

29. Canada notes that Item (d) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* (the "Illustrative List"), distinguishes between the provision of subsidies by "government-mandated schemes" and by "governments or their agencies". "Government-mandated schemes" will usually entail the delegation of authority by government to a private entity. Yet, under Item (d), such an entity does not become a government agency as a result of that delegation of authority.

30. Canada emphasizes that under Canadian domestic law, the provincial milk marketing boards are neither part of the executive branch of any Canadian government nor are they government "agencies". The Panel failed to address the high degree of independence, private accountability and discretion enjoyed by the boards. An entity, such as the provincial milk marketing boards, which act in the private interest of a specific group, cannot be said to be performing government functions, even if it enjoys powers delegated to it by government.

[45]Panel Report, para. 7.56, footnote 404.

[46]Canada's appellant's submission, para. 116.

31. Canada adds, finally, that the judgment in the *Bari III* case, referred to by the Panel, provides no support for the proposition that the provincial milk marketing boards should be deemed to be government agencies because they enjoy some delegated powers.

2. Article 9.1(c) of the *Agreement on Agriculture*

(a) "payments"

32. Canada contends that the Panel erred by collapsing the distinction between the term "payments" in Article 9.1(c) and the term "payments-in-kind" in Article 9.1(a). These words have different meanings: where the drafters intended the word "payments" to include "payments-in-kind", this was indicated in the text, as in the case of Article 9.1(a) and of paragraph 5 of Annex 2. The absence of an express reference to "payments-in-kind" in other provisions of the *Agreement on Agriculture* indicates a different intention. Canada argues that its interpretation is supported by the French and Spanish texts of that Agreement.

33. The Panel also erred by equating a "payment-in-kind" with the provision of a good at a discounted price or "revenue foregone". As regards "revenue foregone", the Panel erred in concluding that, because such revenue counts against a Member's budgetary outlay commitments, *every* type of subsidy listed in Article 9.1 covers "revenue foregone". In Canada's view, it is only if the *specific* sub-paragraph of Article 9.1 can be interpreted to include "revenue foregone" that such revenue is relevant to the subsidy concerned. The Panel also fails to differentiate between "payments-in-kind" and "revenue foregone". In effect, therefore, the Panel errs by collapsing the separate terms, "payments", "payments-in-kind" and "revenue foregone", into a single concept.

(b) "financed by virtue of governmental action"

34. Canada argues that the Panel's finding under Article 9.1(c), that "payments" were "financed by virtue of governmental action", is based expressly on the Panel's findings under Article 9.1(a) regarding "governments and their agencies". The finding under Article 9.1(c) is, therefore, wrong for the same reasons Canada submitted under Article 9.1(a).

35. Canada also points to what it considers to be significant differences between in-quota and over-quota milk as regards the degree of government involvement and contends that the Panel erred by dismissing these differences.[47] Neither the boards nor the CDC determine how much over-quota

[47]The factors regarding in-quota and over-quota milk that Canada identified are mentioned by the Panel in paragraphs 7.83 and 7.99 of the Panel Report.

milk will actually be produced. Canada also underlines the differences in the pooling of returns to producers as between in-quota and over-quota milk.

3. Article 10.1 of the *Agreement on Agriculture*

36. Canada observes that Article 10.1 applies to "subsidies contingent upon export performance", other than those subsidies listed in Article 9.1. The Panel erred by suggesting that the scope of the measures covered by Article 10.1 is drawn from the items listed in Article 9.1. The Panel indicated that a measure, which is partially, but not completely, covered by Article 9.1, should, for that reason, be included under Article 10.1. Canada emphasizes that a practice not included in Article 9.1 can only be an "export subsidy" if it satisfies the definition of that term in Article 1(e) of the *Agreement on Agriculture*. Approximations will not suffice.

37. In interpreting Article 10.1, the Panel sought guidance from the *SCM Agreement*. Although it mentioned both Article 1 and the Illustrative List, the Panel overlooks consideration of Article 1, moving directly to Item (d) of the Illustrative List. The Illustrative List cannot be applied in isolation, but must be considered together with Article 1 of the *SCM Agreement*. Moreover, the Panel also erred by finding that Special Classes 5(d) and 5(e) fulfil the substantive requirements of Item (d) of the Illustrative List.

4. Article II:1(b) of the GATT 1994

38. Canada argues that the Panel overlooked the scope and meaning of Canada's entry in its Schedule of Commitments. In effect, the Panel reduced the language contained in the entry to a nullity by failing to ascribe any limiting effect to it. Instead, the Panel found that the entry contained "terms" relating solely to the way in which the size of the quota was determined. The Panel thereby failed to interpret the word "term" according to its ordinary meaning, which is "limiting conditions". The Panel also erred by failing to set out the basic rationale behind its finding, as required by Article 12.7 of the DSU.

39. The Panel did not take sufficient account of the language in Article II:1(b) of the GATT 1994 which means, in effect, that Canada's access commitments are subordinated to the "terms and conditions" set out in its Schedule of Commitments. By giving the notation no limiting effect on Canada's access obligations, the Panel ignored the words "subject to" in Article II:1(b).

40. Canada acknowledges that the two specific requirements at issue are not expressly provided for in its notation. But the Panel should have recognized a strong presumption that the notation was

intended to restrict access to the tariff-rate quota to "cross-border purchases imported by Canadian consumers".

41. Canada submits that because the Panel failed to ascribe any substantive meaning to Canada's terms and conditions, the Panel also failed properly to interpret the meaning of the word "consumer" in the notation. As a result of its approach, the Panel failed to rule on the central issue, namely, whether Canada must permit commercial import shipments of fluid milk within the two tariff lines in question.

42. In view of the doubts regarding the interpretation of the notation, the Panel should have clarified the meaning by considering the negotiating history pursuant to Article 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*").[48] Canada asserts that it was clear from the record before the Panel that Canada proposed to maintain its existing access opportunities, unless the United States removed barriers to Canadian access to the United States' market. Those existing access opportunities did not extend to commercial imports.

B. *Arguments of New Zealand – Appellee*

1. Article 9.1(a) of the *Agreement on Agriculture*

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

43. New Zealand disagrees with Canada's view that the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement* form a single, comprehensive statement and must, therefore, be interpreted consistently. Even though the *WTO Agreement* may constitute a single undertaking, that does not mean that the provisions of one part are to be governed by the provisions of another part. The various WTO agreements contain provisions that establish a hierarchy between them and this hierarchy must be respected. Furthermore, on Canada's argument, neither Agreement could be applied in isolation, since only by applying the Agreements together could consistency be ensured.

44. Canada seems to argue that the Panel erred because it found that any "payment-in-kind" constitutes a "direct subsidy". New Zealand does not concur in this reading of the Panel Report. The Panel makes it clear that a "payment-in-kind" is *capable* of being a "direct subsidy", *provided* that it can be shown to confer a "benefit".

[48]Done at Vienna, 23 May 1969, 1155 U.N.T.S. 331; (1969) 8 International Legal Materials 679.

45. New Zealand agrees with the Panel that provision of goods at a reduced price can constitute a "payment-in-kind". If processors were to purchase milk at a higher price and receive a rebate, the rebate would undoubtedly be a "payment". In the case of Special Classes 5(d) and 5(e), the rebate is in the form of the provision of milk instead of money.

46. In New Zealand's view, a "benefit" is conferred if access to milk under Special Classes 5(d) and 5(e) results in processors obtaining milk for export at a price which is lower than the price of milk from alternative sources. As the Panel concluded, Special Classes 5(d) and 5(e) do provide a "benefit" because processors would have to pay significantly higher prices for alternative supplies of milk.

47. New Zealand observes that the Panel employed the two benchmarks to assess whether the terms offered under Special Classes 5(d) and 5(e) were available elsewhere in the marketplace. Such an approach was endorsed by the Appellate Body in its Report in *Canada – Measures Affecting the Export of Civilian Aircraft* ("*Canada – Aircraft*").[49]

48. Finally, New Zealand argues that Canada's interpretation of the word "direct" in Article 9.1(a) of the *Agreement on Agriculture* rewrites that provision. If "direct" means funded through government funds, the words "the provision by governments or their agencies" are redundant. Canada's interpretation would also mean that the word "provision" should be understood as being preceded by the word "direct". In New Zealand's opinion, a "direct subsidy" is one that affects trade directly rather than indirectly.

(b) "governments or their agencies"

49. New Zealand notes that Canada challenges only the Panel's conclusion that the provincial milk marketing boards are governmental in character. New Zealand maintains that the provincial milk marketing boards fall within the definition of "governments or their agencies" under Article 9.1(a). It defends this position on the basis of the delegation of power by the government to the boards and on the nature of those powers, which would normally inure to the federal or provincial governments.

50. New Zealand does not share Canada's view that the reference to "marketing boards" as potential recipients of subsidies under Article 9.1(a) means that they cannot be government agencies. There is no single definition of the term "marketing board" and the Panel properly evaluated the particular characteristics of the provincial milk marketing boards at issue here. New Zealand also

[49]Appellate Body Report, WT/DS70/AB/R, adopted 20 August 1999.

contends that both the *Ad* note to Article XVII:1, and Article XXIV:12 of GATT 1994 indicate that marketing boards are capable of being agencies of government, although neither purports to provide a universal definition of government agency.

51. New Zealand disagrees with Canada's argument on Item (d) of the Illustrative List. Item (d) says nothing about the "government" status of "government-mandated schemes" since Item (d) does not depend upon whether those schemes are governmental or non-governmental.

52. Finally, New Zealand contends that Canada's argument that the status of the provincial milk marketing boards should be determined by Canadian domestic law is contrary to Article 3.2 of the DSU, which provides that the WTO Agreements are to be interpreted "in accordance with customary rules of interpretation of public international law."

2. Article 9.1(c) of the *Agreement on Agriculture*

(a) "payments"

53. New Zealand maintains that the Panel properly applied the appropriate principles of treaty interpretation in its examination of the word "payments". A "payment-in-kind" is a *form* of payment. Canada has offered no substantive argument to show that this is wrong.

54. According to New Zealand, Canada's argument regarding revenue foregone suggests that such revenue would be excluded from the assessment of budgetary outlay commitments made for "export subsidies" under Article 9.1, unless there is explicit reference to revenue foregone in a particular sub-paragraph of Article 9.1. Since none of the sub-paragraphs in Article 9.1 refers specifically to revenue foregone, the implication of the Canadian argument is that revenue foregone need not be included at all in the calculation of "budgetary outlay" commitments. This is a rewriting of Articles 1(c), 9.1 and 9.2(a) of the *Agreement on Agriculture*.

(b) "financed by virtue of governmental action"

55. New Zealand submits that, for the reasons given in its arguments on the meaning of "governments or their agencies", the Panel's analysis under Article 9.1(c), insofar as it is based on its analysis under Article 9.1(a), is correct. Canada is attempting to reargue the facts of the case by focusing on differences between in-quota and over-quota milk that the Panel did not regard as significant. The important point is that "governmental action" is involved regardless of whether the milk is in-quota or over-quota.

3. Article 10.1 of the *Agreement on Agriculture*

56. New Zealand submits that Canada fails to take proper account of the purpose of Article 10.1, which is to prevent Members of the WTO circumventing reduction commitments made in respect of export subsidies listed in Article 9.1. When the Panel indicated that Article 10.1 covered subsidies that did not meet all of the definitional elements of Article 9.1, it was precisely this type of circumvention that the Panel was aiming at. The Panel did not find that it suffices that a measure approximates an "export subsidy" under Article 9.1. The Panel emphasized that the alleged subsidy must meet the requirements of Article 1(e) of the *Agreement on Agriculture*.

57. As with Article 9.1(a) of the *Agreement on Agriculture*, New Zealand considers that the *SCM Agreement* is not the appropriate starting-point for interpretation of the *Agreement on Agriculture*. That Agreement must be interpreted according to its own terms. In any event, New Zealand agrees with the Panel that Special Classes 5(d) and 5(e) are "export subsidies" within the meaning of Item (d) of the Illustrative List.

C. *Arguments of the United States – Appellee*

1. Article 9.1(a) of the *Agreement on Agriculture*

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

58. The United States submits that the Panel correctly concluded, first, that Special Classes 5(d) and 5(e) provide a "payment-in-kind" to dairy processors and, second, that the "payment-in-kind" is a "direct subsidy" provided by the Canadian federal and provincial governments, working through the provincial milk marketing boards.

59. Canada argues that the provision of goods at a price lower than their value is not a "payment-in-kind", although the provision of goods free of charge is. However, this position would allow circumvention of Article 9.1(a) by the imposition of a minimal fee, regardless of how small, for the goods.

60. The United States agrees with Canada that the *SCM Agreement* is relevant to the interpretation of the *Agreement on Agriculture*, but its provisions are not to be given more weight than those of the *Agreement on Agriculture*. A practice which falls within Article 9.1 of the *Agreement on Agriculture* is an "export subsidy" for the purposes of that Agreement, irrespective of whether the practice is also an "export subsidy" under the *SCM Agreement*.

61. The United States does not consider that the Panel "equated" "payments-in-kind" with "subsidies". First, the Panel focused on the circumstances of this case by referring to the "instant matter".[50] Furthermore, the Panel's finding under Article 9.1(a) is not dependent solely on the term "payments-in-kind", but was an application of the provision in its entirety. The Panel's analysis of whether the "payment-in-kind" conferred a "benefit" is part of the Panel's consideration of the subsidy issue under Article 9.1(a) as a whole.

62. Canada's argument as to the meaning of "direct" is also flawed. The term "direct" reveals nothing about either the grantor of a subsidy or the source of the funds. Indeed, Canada's own Special Import Measures Act (SIMA) Handbook relies on a very different understanding of the word "direct". It states that "a direct . . . benefit is one which accrues directly to the person, firm, or industry which is the intended recipient". This is in contrast to "an indirect benefit . . . which does not accrue directly, but which alters the economic environment within which firms operate."

63. The United States contends that Canada's argument on the first benchmark is superfluous to the appeal because the Panel relied on the second benchmark, and not the first, in making its finding. Under the second benchmark, the Panel established that there were no alternative supplies of milk, or competing products, that were available to processors on terms as favorable as those offered under Special Classes 5(d) and 5(e).

(b) "governments or their agencies"

64. The United States notes that Canada does not challenge either the governmental status or the role of the CDC in the regulatory framework. Canada's appeal against the Panel's findings on this issue turns exclusively on the status of the provincial milk marketing boards.

65. The Panel did *not* focus simply on the delegation of powers to the marketing boards. Instead, the Panel also considered the functions of the boards, as well as the extent to which the provincial and federal governments retain supervisory oversight over the boards.

66. The ordinary meaning of the word "agency" is not restricted to a department or other section of the government itself but also embraces entities acting on an agency basis. This meaning clearly does not exclude private entities acting for the government.

67. The United States disagrees with Canada that the reference in Article 9.1(a) to "marketing boards" as potential recipients of "direct subsidies" precludes "marketing boards" from being

[50]Panel Report, para. 7.43.

government agencies in appropriate circumstances. This interpretation is not justified by the text of Article 9.1.

68. Finally, Canada's argument on Item (d) of the Illustrative List is based entirely on the assumption that "government-mandated schemes" always involve the delegation of governmental authority. The United States does not agree with this assumption.

2. Article 9.1(c) of the *Agreement on Agriculture*

(a) "payments"

69. Contrary to Canada's arguments, the Panel did not equate "payment" with "payment-in-kind". The Panel correctly found that "payments-in-kind" represent a subset of the broader term "payment". Canada, however, treats the two terms as mutually exclusive. This position is untenable given the ordinary definition of "payment" as the "remuneration of a person with money or its equivalent".[51]

70. Canada is also incorrect to suppose that "payments-in-kind" are only included in the scope of the *Agreement on Agriculture* where express provision is made to that effect. To the contrary, the express reference to "payments-in-kind" is necessary to prevent the terms "direct subsidy" (in Article 9.1(a) of the *Agreement on Agriculture*) and "direct payment" (in Paragraph 5 of Annex 2 of that Agreement) from being interpreted narrowly to exclude "payments-in-kind".

71. According to the United States, the Panel was correct to find that the word "payment" in Article 9.1(c) includes "revenue foregone". The drafters did not qualify the word "payment" in Article 9.1(c) in any way. Consistently with its ordinary meaning, the word covers transfers of value to another person or entity. Such a transfer occurs when one party foregoes revenue for the advantage or benefit of another. The fact that the Panel found that the word "payment" encompassed both "payments-in-kind" and "revenue foregone" does not mean, as Canada argues, that these terms are synonymous.

(b) "financed by virtue of governmental action"

72. The United States argues that "financed by virtue of governmental action" under Article 9.1(c) is a less demanding requirement than "the provision by governments or their agencies of direct subsidies" under Article 9.1(a). Activities of "governments or their agencies" that do not fall within Article 9.1(a) may satisfy the requirement of Article 9.1(c).

[51]See Panel Report, 7.92.

73. The United States disputes Canada's suggestion that the Panel's findings under Article 9.1(c) do not stand independently from the Panel's conclusions under Article 9.1(a). Under Article 9.1(c), the Panel examined in exhaustive detail the involvement of government in the functioning and control of Special Classes 5(d) and 5(e) and Canada has not refuted the Panel's specific factual findings concerning the breadth of that involvement.

74. The United States considers that, for all relevant purposes, the role of the Canadian governments and of the provincial milk marketing boards under Special Classes 5(d) and 5(e) is the same. It makes no difference from the perspective of the *processors* whether the milk they receive is in-quota or over-quota because the price to them is the same. The United States rejects Canada's argument that it is significant that producers decide themselves whether to produce over-quota milk. If mandating the production of milk were a prerequisite for a finding of a subsidy, the subsidies disciplines would be altogether eviscerated.

3. Article 10.1 of the *Agreement on Agriculture*

75. Canada's arguments on Article 10.1 reflect a mistaken reading of the Panel Report. Contrary to Canada's argument, the Panel did not state that any measure which does not satisfy some of the elements of Article 9.1 would, without more, be an export subsidy under Article 10.1. The Panel found that even a measure which meets most of the criteria in Article 9.1 must still satisfy the requirements of Article 1(e) of the *Agreement on Agriculture*.

76. By arguing that the Panel should have assessed Special Classes 5(d) and 5(e) in terms of Article 1.1 of the *SCM Agreement*, rather than just in light of Item (d) of the Illustrative List, Canada is implicitly suggesting that the export subsidies identified in the Illustrative List might not satisfy the criteria set forth in Article 1.1. This is not possible. As a matter of definition, Article 3.1 of the *SCM Agreement* mandates that *all* subsidies described in the Illustrative List are subsidies for purposes of Article 1 of the *SCM Agreement*.

77. The United States argues, in any event, that Special Classes 5(d) and 5(e) involve "subsidies" within the meaning of Article 1.1 of the *SCM Agreement* and, moreover, that the Panel was correct to conclude that these Special Classes fall within Item (d) of the Illustrative List.

4. Article II:1(b) of the GATT 1994

78. Consistently with the rules of treaty interpretation, the Panel was aware of the context of the language in the notation in Canada's Schedule. Nevertheless, the Panel could not find, in that language, the specific access restrictions contended for by Canada.

79. The United States disagrees with Canada that the most relevant meaning of the word "term" is "limiting conditions", as this meaning would render the word "conditions", in the phrase "terms and conditions", entirely superfluous. It is reasonable to assume that the words "other terms and conditions" contained in Canada's Schedule are intended to mirror the language used in Article II:1(b). The similar language in this provision has been interpreted as indicating not simply additional conditions.[52] Accordingly, there is no reason for giving the entry a narrower interpretation than is justified by the ordinary meaning of its wording.

80. According to the United States, the only operative word in Canada's notation is the word "represents". However, that word gives the notation no legally operative effect. It is not the same as saying "access is limited to", or "this quantity is available only for", language which Canada could have added, as it did with respect to yoghurt and ice cream.

81. The United States agrees with the Panel's interpretation of the word "consumer".[53] The Panel was not required to spell out that "consumer" also embraces entities such as processors that "consume" milk in manufacturing. The Panel did not ignore the core issue, but found that the notation did not support the two restrictions imposed by Canada.

82. The requisite conditions for resorting to Article 32 of the *Vienna Convention* were not met and, thus, the Panel was not compelled to take into account the negotiating history. Moreover, even if Article 32 were applicable, a panel is not *required* to look to the negotiating history. That is simply "permitted". In any event, the negotiating history does not establish the existence of a common understanding between Canada and the United States that confirms Canada's interpretation of the notation.

[52]The United States cites the panel report in *United States – Restrictions on Imports of Sugar*, adopted 22 June 1989, BISD 36S/331, para. 5.6.

[53]See Panel Report, para. 7.152.

IV. Issues Raised In This Appeal

83. This appeal raises the following issues:

(a) whether the Panel erred in its interpretation and application of Article 9.1(a) of the *Agreement on Agriculture*, in particular, with respect to:

i) the expression "direct subsidies, including payments-in-kind", and
ii) the expression "governments or their agencies";

(b) whether the Panel erred in its interpretation and application of Article 9.1(c) of the *Agreement on Agriculture*, in particular, with respect to:

i) the term "payments", and
ii) the expression "financed by virtue of governmental action";

(c) whether the Panel erred in its interpretation and application of the term "export subsidies" in Article 10.1 of the *Agreement on Agriculture*; and

(d) whether the Panel erred in finding that Canada has acted inconsistently with its obligations under Article II:1(b) of the GATT 1994 by restricting access to the tariff-rate quota for fluid milk to consumer packaged milk for personal use, valued at less than C$20, imported under the authority of General Import Permit No. 1.

V. Article 9.1(a) of the *Agreement on Agriculture*

A. "*Direct Subsidies, Including Payments-In-Kind*"

84. The Panel stated that "'payments-in-kind' are a form of direct subsidy."[54] For the Panel, it followed that "a determination in the instant matter that '*payments-in-kind*' exist *would also be* a determination of the existence of a *direct subsidy*."[55] (emphasis added) The Panel next proceeded to consider the meaning of the term "payments-in-kind". It concluded that the ordinary meaning of the word "payments", in the term "payments-in-kind", "connotes a gratuitous act, a bounty or benefit provided, for example, in pursuit of a policy objective".[56] According to the Panel, this meaning is "mandated by the general context of this provision which includes Article 1 of the

[54]Panel Report, para. 7.43.
[55]*Ibid.*
[56]*Ibid.*, para. 7.44.

SCM Agreement."[57] On the basis of this interpretive framework, the Panel examined whether Special Classes 5(d) and 5(e) provide a "benefit". It reached the conclusion that a "benefit" was conferred and that there was, therefore, a "payment-in-kind".[58] On the grounds that this "payment-in-kind" was provided by Canada's "governments or their agencies", the Panel found that "the making available of milk under Classes 5(d) and (e) constitutes an export subsidy within the meaning of Article 9.1(a)."[59]

85. Canada submits that the Panel's interpretive approach is flawed. It believes that the Panel has equated "payments-in-kind" with "direct subsidies", and "payments", as used in "payments-in-kind", with "benefit". Thus, in Canada's view, the Panel, in essence, equated "direct subsidies" with "benefit".

86. On our reading of the Panel Report, the Panel took the view that if "payments-in-kind" were provided by "governments or their agencies", "direct subsidies" were also provided. In other words, the Panel found that a "payment-in-kind" is *necessarily* a "direct subsidy". This is clear from the Panel's statement that "a determination … that 'payments-in-kind' exist would also be a determination of the existence of a direct subsidy."[60] Moreover, this understanding of the Panel's reasoning is borne out by the Panel's subsequent analysis. At no point did the Panel examine whether the "payments-in-kind" that it found to exist were "subsidies", let alone "direct subsidies". To the contrary, the Panel's finding under Article 9.1(a) resulted from its conclusion that the provision of reduced priced milk to processors for export under Special Classes 5(d) and (e) constitutes "payments-in-kind" provided by Canada's "governments or their agencies".[61] In making this finding, the Panel did not make any reference to the measures being "direct subsidies". It assumed that because the measures were "payments-in-kind" they were, therefore, also "direct subsidies".

87. In our view, the term "payments-in-kind" describes one of the *forms* in which "direct subsidies" may be granted. Thus, Article 9.1(a) applies to "direct subsidies", *including* "direct subsidies" granted in the form of "payments-in-kind". We believe that, in its ordinary meaning, the word "payments", in the term "payments-in-kind", denotes a transfer of economic resources, in a form other than money, from the grantor of the payment to the recipient. However, the fact that a "payment-in-kind" has been made provides no indication as to the economic *value* of the transfer effected, either from the perspective of the grantor of the payment or from that of the recipient. A

[57]Panel Report, para. 7.44.

[58]*Ibid*., paras. 7.58 and 7.62.

[59]*Ibid*., para. 7.87.

[60]*Ibid*., para. 7.43.

[61]*Ibid*., para. 7.87.

"payment-in-kind" may be made in exchange for full or partial consideration or it may be made gratuitously. Correspondingly, a "subsidy" involves a transfer of economic resources from the grantor to the recipient for less than full consideration. As we said in our Report in *Canada – Aircraft*, a "subsidy", within the meaning of Article 1.1 of the *SCM Agreement*, arises where the grantor makes a "financial contribution" which confers a "benefit" on the recipient, as compared with what would have been otherwise available to the recipient in the marketplace.[62] Where the recipient gives full consideration in return for a "payment-in-kind" there can be no "subsidy", for the recipient is paying market-rates for what it receives. It follows, in our view, that the mere fact that a "payment-in-kind" has been made does not, *by itself*, imply that a "subsidy", "direct" or otherwise, has been granted.

88. We, therefore, conclude that the Panel erred in finding that "a determination in the instant matter that 'payments-in-kind' exist would also be a determination of the existence of a direct subsidy."[63] The Panel should have considered whether the particular "payment-in-kind" that it found existed was a "direct subsidy". Instead, because the Panel assumed that a "payment-in-kind" is necessarily a "direct subsidy", it did not address specifically either the meaning of the term "direct subsidies" or the question whether the provision of milk to processors for export under Special Classes 5(d) and 5(e) constitutes "direct subsidies".

89. We have just found that the term "payments-in-kind" describes a transfer of economic resources, in a form other than money, but that the term gives no indication as to the economic value of that transfer or as to whether there is a subsidy.[64] The Panel, however, interpreted the word "payments", in the term "payments-in-kind", as connoting "a *gratuitous* act, a *bounty* or *benefit*".[65] (emphasis added) To us, each of these meanings describes the economic value of a transfer, both from the perspective of the grantor and of the recipient. These meanings all infer that the economic resources transferred by way of the payment were given in exchange for less than full value and, in the case of a "gratuitous" payment, without any exchange of value at all. While we acknowledge that a "payment" *may* be made "gratuitously", the ordinary meaning of the word also encompasses a transfer of economic resources made for full or partial consideration. We, therefore, find that the Panel erred in holding that the word "payments", in the term "payments-in-kind", *necessarily* "connotes a gratuitous act, a bounty or benefit".[66]

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[62]*Supra*, footnote 49, paras. 156 and 157.

[63]Panel Report, para. 7.43.

[64]*Supra*, para. 87.

[65]Panel Report, para. 7.44.

[66]*Ibid*.

90. We also note that the Panel's reliance on the *SCM Agreement* in interpreting Article 9.1(a) of the *Agreement on Agriculture* was not consistent. The concept of "benefit" is an integral part of the definition of "*subsidy*" in Article 1.1 of the *SCM Agreement*. Yet, on the one hand, the Panel used this term, not to assist in defining the term "direct *subsidies*" in Article 9.1(a) of the *Agreement on Agriculture*, but to define the word "*payment*". However, on the other hand, the Panel failed entirely to make any mention of the other integral aspect of a "subsidy" under Article 1.1 of the *SCM Agreement*, namely the need for a "financial contribution". The Panel did not explain why one aspect of the definition of a "subsidy" in the *SCM Agreement* is relevant in interpreting Article 9.1(a) of the *Agreement on Agriculture*, while the other is not.

91. Thus, on our reading of the Panel Report, the Panel equated a "payment-in-kind" with a "direct subsidy", and then equated a "payment-in-kind" with a "benefit". For the Panel, it followed logically from the existence of a "benefit" that a "direct subsidy" also existed. If the "benefit" was provided by "governments or their agencies", it followed, furthermore, that there was an export subsidy as listed in Article 9.1(a) of the *Agreement on Agriculture*. It was on the basis of this flawed interpretive approach that the Panel found, in paragraph 7.87 of its Report, that export subsidies as listed in Article 9.1(a) are granted through Special Classes 5(d) and 5(e). Since we have held that the interpretive approach which underlies the finding in paragraph 7.87 of the Panel Report is wrong, it follows that that finding is itself tainted by the same errors of law. The conferral of a "benefit" does not necessarily constitute a "payment-in-kind", and a "payment-in-kind" is not necessarily a "direct subsidy".[67] Thus, the Panel's assessment that a "benefit", and hence a "payment-in-kind", are provided by "governments or their agencies" does not, in our view, warrant the conclusion that export subsidies are conferred.

92. We, therefore, reverse the Panel's interpretive approach, in paragraphs 7.43 and 7.44 of its Report, regarding the terms "direct subsidies" and "payments-in-kind". Since the Panel's finding in paragraph 7.87 of its Report that Special Classes 5(d) and 5(e) involve export subsidies under Article 9.1(a) of the *SCM Agreement* is based, in part, on the Panel's flawed interpretive approach, which we hereby reverse, we also reverse the finding of the Panel in paragraph 7.87. However, in view of our findings below on Article 9.1(c) of the *Agreement on Agriculture*, we do not find it necessary to examine in this Report whether export subsidies, as listed in Article 9.1(a), are conferred through Special Classes 5(d) and 5(e) and we, therefore, reserve our judgment on this question.

[67]Panel Report, paras. 7.43 and 7.58.

B. "*Governments or their Agencies*"

93. The Panel identified the CDC, the provincial milk marketing boards and the CMSMC as playing "a direct decision-making role" in administering Special Classes 5(d) and 5(e).[68] Canada does not appeal the Panel's conclusion that the CDC, a federal Crown corporation, is an "agency" of government within the meaning of Article 9.1(a), nor does Canada specifically appeal the Panel's finding regarding the CMSMC. As regards the provincial milk marketing boards, the Panel found that they were:

> … established and operate *within a legal framework set up by federal and provincial legislation*. These boards exercise powers in respect of inter-provincial and external trade delegated to them by the federal government through the CDC, as well as powers delegated to them by provincial authorities. Three of these boards (Alberta, Nova Scotia and Saskatchewan) are, according to Canada, agencies of the provincial government. Orders or regulations issued by the provincial marketing boards can be *enforced before the Canadian courts*. In most provinces, individual decisions by the boards are subject to appeal to a provincial supervisory board or commission (of which Canada recognizes the governmental nature).[69] (emphasis added)

94. It was against this factual background that the Panel concluded that:

> It is precisely *because* the boards receive the authority from the governments to regulate certain areas themselves that their actions become governmental. What is important though is that Canadian governments maintain the ultimate control and supervision of most, if not all, of the boards' activities. These governments define, and approve changes to, the boards' mandates and functions.[70] (underlining added)

95. Since the Panel found that all of the bodies that play a decision-making role in the CMSMC are "government agencies", the Panel found that the actions of the CMSMC were the actions of a "government agency".[71]

96. Canada's appeal focuses on the Panel's findings that the provincial milk marketing boards are "government agencies". Canada takes the view that the Panel erred in law in deciding that these

[68]Panel Report, para. 7.74.

[69]*Ibid*., para. 7.76.

[70]*Ibid*., para. 7.78.

[71]*Ibid*., para. 7.80. The bodies involved in the CMSMC are set forth in paragraph 7.79 of the Panel Report.

boards are "government agencies" "*solely on the basis of one characteristic*: the delegation of some governmental authority."[72] (emphasis added)

97. We start our interpretive task with the text of Article 9.1(a) and the ordinary meaning of the word "government" itself. According to *Black's Law Dictionary*, "government" means, *inter alia*, "[t]he *regulation*, *restraint*, *supervision*, or *control* which is exercised upon the individual members of an organized jural society *by those invested with authority*".[73] (emphasis added) This is similar to meanings given in other dictionaries.[74] The essence of "government" is, therefore, that it enjoys the effective power to "regulate", "control" or "supervise" individuals, or otherwise "restrain" their conduct, through the exercise of lawful authority. This meaning is derived, in part, from the *functions* performed by a government and, in part, from the government having the *powers* and *authority* to perform those functions. A "government agency" is, in our view, an entity which exercises powers vested in it by a "government" for the purpose of performing functions of a "governmental" character, that is, to "regulate", "restrain", "supervise" or "control" the conduct of private citizens. As with any agency relationship, a "government agency" may enjoy a degree of discretion in the exercise of its functions.[75]

98. In the present case, the Panel seems to us to have applied precisely these concepts in concluding that the provincial milk marketing boards are "government agencies". Contrary to Canada's assertions, the Panel's conclusion is not based on the *sole* fact that the provincial milk marketing boards enjoy authority delegated to them by governments. To the contrary, the Panel examined both the *source* of the provincial boards' powers and the *functions* performed by those boards in the exercise of their powers. We note, furthermore, that as regards three of the provincial boards, Canada acknowledged that they were "agencies" of certain provincial governments of Canada.[76]

99. As regards the *source* of the provincial milk marketing boards' powers, it is clear that, in the words of the Panel, they "operate within a legal framework set up by federal and provincial legislation."[77] Furthermore, the provincial boards' powers and functions may only be modified by

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[72]Canada's appellant's submission, para. 116.

[73]*Black's Law Dictionary* (West Publishing Co., 1990), p. 695. The same dictionary states that "[t]he term 'jural society' is used as the synonym of 'state' or 'organized political community'" (p. 851).

[74]*The New Shorter Oxford English Dictionary*, Lesley Brown (ed.) (Clarendon Press, 1993), Vol. I, p. 1123; *Merriam Webster's Collegiate Dictionary*, Frederick Mish (ed.) (Merriam Webster Inc., 1993), p. 504.

[75]*Black's Law Dictionary*, *supra*, footnote 73, pp. 62 and 63.

[76]The boards in question are those of Alberta, Nova Scotia and Saskatchewan.

[77]Panel Report, para. 7.76.

"governments".[78] In these circumstances, it is clear, as the Panel said, that "these boards act under the *explicit authority delegated to them by either the federal or a provincial government*."[79] (emphasis added) Indeed, we are of the view that Canada accepts that the provincial milk marketing boards act on the basis of delegated powers vested in them by federal and provincial "governments". On appeal, Canada does not argue that there is *no* delegation of powers by its "governments" to these boards, but, rather, that the delegation of powers is not a sufficient basis, *on its own*, for a finding that such entities are "government agencies".[80]

100. The Panel did not, however, rely solely on the fact of the delegation of powers. The Panel also examined the *functions* of the provincial milk marketing boards and concluded that their powers enable them, again in the words of the Panel, to "*regulate*" a particular sector of the economy, namely the dairy sector.[81] The "governmental" character of the boards' functions, as well as the extent of their regulatory control, is underlined by the fact that their orders and regulations are enforceable in courts of law.[82] Thus, the powers of the provincial boards are augmented by the machinery of the State itself, and the boards have at their disposal the public force to ensure that their regulatory functions and decisions are carried out. Although the provincial boards enjoy a high degree of discretion in the exercise of their powers, governments retain "ultimate control" over them.[83] The Panel was, therefore, correct to conclude that the provincial milk marketing boards are "government agencies".

101. Moreover, the presence of dairy producers as officers of the provincial boards does not compel a change in our view. Irrespective of the composition of the boards, the source of their powers is still "governments" and the nature of the functions that they exercise is still "governmental". Nor is our opinion altered by the fact that the provincial boards exercise their powers with a view to promoting the interests of particular traders, namely, the producers. In our view, it is part of the normal functioning of "governments" to promote the perceived interests of the State, and this may involve securing the interests of one or more sectors of the community.

102. In light of the foregoing, we uphold the Panel's finding in paragraph 7.80 of the Panel Report, that the provincial milk marketing boards are "agencies" of Canada's governments.

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[78]Panel Report, para. 7.78.

[79]*Ibid*., para. 7.77.

[80]*Supra*, para. 96.

[81]Panel Report, para. 7.77.

[82]*Ibid*., para. 7.76.

[83]*Ibid*., para. 7.78.

VI. Article 9.1(c) of the *Agreement on Agriculture*

A. "*Payments*"

103. In determining whether Special Classes 5(d) and 5(e) involve "payments" under Article 9.1(c), the Panel recalled that it had already found that "the provision of milk at a discounted price under Classes 5(d) and (e) involves 'payments-in-kind' in the sense of Article 9.1(a)".[84] It followed that, if the word "payments" in Article 9.1(c) embraced "payments-in-kind", Special Classes 5(d) and 5(e) would involve "payments".[85]

104. Based on the *Oxford English Dictionary* definition of the word "payment", the Panel took the view that:

> … the ordinary meaning of the word "payment" includes both the act of remunerating a person with money and the act of remunerating a person with its equivalent in kind, a so-called "payment in kind".[86]

105. The Panel found that this meaning was confirmed by the context of the word, which in the Panel's view, included: the words "a charge" and "financed" in Article 9.1(c) itself; the concept of "revenue foregone", that is included in the term "budgetary outlays", mentioned in Article 9.2(a) and defined in Article 1(c); as well as the other "export subsidies" listed in Article 9.1 of the *Agreement on Agriculture*. On this basis, the Panel found that Special Classes 5(d) and 5(e) involved "payments" within the meaning of Article 9.1(c).[87]

106. Canada argues that the Panel erred by collapsing the distinction between "payments" in Article 9.1(c) and "payments-in-kind" in Article 9.1(a). Canada maintains that the concept of "payments-in-kind" is only included in those provisions of the *Agreement on Agriculture* that make express mention of the concept, which Article 9.1(c) does not. Moreover, Canada asserts that the Panel erred by relying on "revenue foregone" under Article 9.1(c). "Revenue foregone" is not relevant to all the sub-paragraphs of Article 9.1, but only to those which can be interpreted as including "revenue foregone". Article 9.1(c) is not such a sub-paragraph. Finally, even if Article 9.1(c) were to apply to "payments-in-kind", Canada disagrees with the Panel that Special Classes 5(d) and 5(e) involve "payments-in-kind".

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[84]Panel Report, para. 7.90.

[85]*Ibid*.

[86]*Ibid*., para. 7.92.

[87]*Ibid*., para. 7.101.

107. We have found that the word "payments", in the term "payments-in-kind" in Article 9.1(a), denotes a transfer of economic resources.[88] We believe that the same holds true for the word "payments" in Article 9.1(c). The question which we now address is whether, under Article 9.1(c), the economic resources that are transferred by way of a "payment" must be in the form of money, or whether the resources transferred may take other forms. As the Panel observed, the dictionary meaning of the word "payment" is not limited to payments made in monetary form. In support of this, the Panel cited the *Oxford English Dictionary*, which defines "payment" as "the remuneration of a person with money *or its equivalent*".[89] (emphasis added) Similarly, the *Shorter Oxford English Dictionary* describes a "payment" as a "sum of money (*or other thing*) paid".[90] (emphasis added) Thus, according to these meanings, a "payment" could be made in a form, other than money, that confers value, such as by way of goods or services. A "payment" which does not take the form of money is commonly referred to as a "payment in kind".

108. We agree with the Panel that the ordinary meaning of the word "payments" in Article 9.1(c) is consistent with the dictionary meaning of the word. Under Article 9.1(c), "payments" are "financed by virtue of governmental action" and they may or may not involve "a charge on the public account". Neither the word "financed" nor the term "a charge" suggests that the word "payments" should be interpreted to apply solely to money payments. A payment made in the form of goods or services is also "financed" in the same way as a money payment, and, likewise, "a charge on the public account" may arise as a result of a payment, or a legally binding commitment to make payment by way of goods or services, or as a result of revenue foregone.

109. The context of Article 9.1(c) also supports a reading of the word "payments" that embraces "payments-in-kind". That context includes the other sub-paragraphs of Article 9.1. As the Panel explained, *none* of the export subsidies listed in Article 9.1 is restricted to grants made solely in money form and several expressly involve subsidies granted in a form other than money.[91] Under Article 9.1(a), "payments-in-kind" are specifically included as a form of "direct subsidies". Similarly, under Articles 9.1(b), the export subsidy identified may involve the disposal of agricultural goods *at less than domestic price*. Under Article 9.1(e), the provision of transport services for export shipments at *prices lower than the price charged for domestic shipments* is also an export subsidy.

[88] *Supra*, para. 87.

[89] Panel Report, para. 7.92.

[90] *The Shorter Oxford English Dictionary*, C.T. Onions (ed.) (Guild Publishing, 1983), Vol. II, p. 1532.

[91] See Panel Report, para. 7.95.

Thus, each of these three sub-paragraphs of Article 9.1 specifically contemplates that the export subsidy may be granted in a form other than a money payment.

110. The context, in our view, also includes Article 1(c) of the *Agreement on Agriculture*. In terms of that provision, "revenue foregone" is to be taken into account in determining whether "budgetary outlay" commitments, made with respect to export subsidies as listed in Article 9.1, have been exceeded. In our view, the foregoing of revenue usually does not involve a monetary payment. Thus, if a restrictive reading of the words "payments" were adopted, such that "payments" under Article 9.1(c) had to be monetary, no account could be taken, under Article 9.1(c), of "revenue foregone". This would, we believe, prevent a proper assessment of the commitments made by WTO Members under Article 9.2, as envisaged by Article 1(c) of the *Agreement on Agriculture*. We, therefore, prefer a reading of Article 9.1(c) that allows full account to be taken of "revenue foregone". The contrary view would, in our opinion, elevate form over substance and permit Members to circumvent the subsidy disciplines set forth in Article 9 of the *Agreement on Agriculture*.

111. It is true, as Canada argues, that Article 9.1(c) does not expressly include "payments-in-kind" within its scope, whereas Article 9.1(a) and paragraph 5 of Annex 2 to the *Agreement on Agriculture* do. However, we do not regard the express inclusion of "payments-in-kind" in these two provisions as necessarily implying the exclusion of "payments-in-kind" under Article 9.1(c). In Article 9.1(a) and in paragraph 5 of Annex 2, the term "payments-in-kind" is used in conjunction with the words "*direct* subsidies" and "*direct* payments", respectively. We believe that reference is made to "payments-in-kind" in these two provisions to counter any suggestion that the ordinary meaning of the terms "*direct* subsidies" and "*direct* payments" does *not* include "payments-in-kind". By contrast, since the ordinary meaning of the word "payments" in Article 9.1(c) includes "payments-in-kind", there was no need for "payments-in-kind" to be expressly provided for. Moreover, if "payments-in-kind" are *included* in the qualified concept of "direct payments" under Annex 2, paragraph 5, it would be incongruous to *exclude* them from the broader concept of "payments" in Article 9.1(c).

112. We, therefore, agree with the Panel that the ordinary meaning of the word "payments" in Article 9.1(c) encompasses "payments" made in forms other than money, including revenue foregone.

113. In our view, the provision of milk at discounted prices to processors for export under Special Classes 5(d) and 5(e) constitutes "payments", in a form other than money, within the meaning of Article 9.1(c). If goods or services are supplied to an enterprise, or a group of enterprises, at reduced rates (that is, at below market-rates), "payments" are, in effect, made to the recipient of the portion of the price that is not charged. Instead of receiving a monetary payment equal to the revenue foregone,

the recipient is paid in the form of goods or services. But, as far as the recipient is concerned, the economic value of the transfer is precisely the same.

114. We, therefore, uphold the Panel's finding, in paragraph 7.101 of the Panel Report, that the provision of discounted milk to processors or exporters under Special Classes 5(d) and 5(e) involves "payments" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

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

115. The Panel noted at the outset of its analysis on this issue that the parties did not contest that:

> … payments-in-kind made under Classes 5(d) and (e) do *not* directly involve a charge on the public account. The cost of selling milk at a reduced price for export is not borne by the government. It is borne by the milk producers … [92] (underlining added)

116. The Panel observed that such "producer-financed payments" can nonetheless be covered by Article 9.1(c), provided they are "financed by virtue of governmental action".[93] The Panel found that the "payments" made under Special Classes 5(d) and 5(e) were financed in this way.[94] In reaching this conclusion, the Panel relied on a number of factors. These included the facts that: the supply of milk under Special Classes 5(d) and 5(e) is managed by "agencies" of the Canadian federal or provincial governments, within the meaning of Article 9.1(a); these "agencies" determine when and what quantity of milk may be processed for export under those Special Classes; they negotiate the sale price of the milk with the processor or exporter; they enable the processor or exporter to take delivery of the milk; they collect the price paid for the milk by the processors or exporters; they determine the rules for the pooling of returns to producers for in-quota milk, as well as the rules for the more limited pooling of returns for over-quota milk; in the implementation of these rules, they determine the effective selling price of milk for the producers; they pay out those returns to producers; and, they monitor and supervise the operation of Special Classes 5(d) and 5(e).[95]

[92]Panel Report, para. 7.102.

[93]*Ibid*., para. 7.102.

[94]*Ibid*., paras. 7.106, 7.111 and 7.112.

[95]The considerations relied on by the Panel are set out in detail in paragraphs 7.103, 7.104, 7.105, 7.108, 7.109, 7.110, 7.111 and 7.112 of the Panel Report.

117. In arguing that the Panel erred in finding that "payments" made under Special Classes 5(d) and 5(e) are "financed by virtue of governmental action", Canada maintains, first, that this finding is based on the Panel's earlier finding that the provincial milk marketing boards are "government agencies" under Article 9.1(a). Since Canada believes that the Panel's finding under Article 9.1(a) is erroneous, Canada also believes that the finding under Article 9.1(c) is flawed. Canada contends, moreover, that the "payments" are not "financed by virtue of governmental action" because the provincial milk marketing boards are composed, at least in part, of milk producers and act in the interest of those producers. Finally, Canada considers that the Panel failed to take sufficient account of important differences between the treatment of in-quota and over-quota milk, in particular, as regards the pooling of returns to producers.

118. We have rejected Canada's appeal against the Panel's finding that the provincial milk marketing boards are "government agencies".[96] Canada's first argument that the Panel's finding under Article 9.1(c) is flawed to the extent that it is based on the Panel's finding under Article 9.1(a) must, therefore, be dismissed. In our view, since all of the bodies involved in the supply of milk under Special Classes 5(d) and 5(e) are "government agencies" under Article 9.1(a), a strong presumption arises that their conduct in managing those Special Classes may appropriately be regarded as "governmental action".

119. In assessing whether the Panel erred in finding that the "payments" made under Special Classes 5(d) and 5(e) are "financed *by virtue of* governmental action", it is appropriate to look to the "governmental" involvement as whole and not just to the role of the provincial milk marketing boards. The functioning of the system depends on a complex regulatory web involving the CDC and the CMSMC, acting together with the provincial milk marketing boards. It is, therefore, the "action" of all these bodies together which must be examined.

120. While the "cost of selling milk at a reduced price for export is not borne by the government"[97], "governmental action" is, in our view, indispensable to the transfer of resources that takes place as a result of the operation of Special Classes 5(d) and 5(e). The factors relied upon by the Panel, which we have summarized above[98], demonstrate that at *every* stage in the supply of milk under Special Classes 5(d) and 5(e), from the determination of the volume and the authorization of the purchase of milk for processing for export, to the calculation of the price of the milk to the processors and the return to the producers, "governmental action" is not simply involved; it is, in fact,

[96] *Supra*, para. 102.

[97] Panel Report, para. 7.102.

[98] *Supra*, para. 116.

indispensable to enable the supply of milk to processors for export, and hence the transfer of resources, to take place. In the regulatory framework, "government agencies" stand so completely between the producers of the milk and the processors or the exporters that we have no doubt that the transfer of resources takes place "by virtue of governmental action".

121. We have already found, in our reasoning under Article 9.1(a), that the fact that the provincial milk marketing boards are composed, in part, of producers and act in their interests, does not alter the "governmental" character of the provincial boards' "actions".[99] Nor does the fact that, under Special Class 5(e), in-quota returns to *producers* are pooled very differently from over-quota returns alter our conclusion. The price paid for the milk by the *processors* is not, in any way, dependent on whether milk is part of in-quota or over-quota production. Moreover, even though the two pooling mechanisms differ in significant respects, they both nevertheless involve "governmental action" that remains an essential aspect of the financing of the "payments" to processors or exporters.

122. For these reasons, we, therefore, agree with the Panel's findings[100] that the "payments" made under Special Classes 5(d) and 5(e) are "financed by virtue of governmental action" within the meaning of Article 9.1(c) of the *Agreement on Agriculture*.

123. In light of all of the foregoing, we believe and so hold that the Panel was correct in finding, in paragraph 7.113 of the Panel Report, "that the making available of milk under Classes 5(d) and (e) constitutes an export subsidy within the meaning of Article 9.1(c)."

VII. Article 10.1 of the *Agreement on Agriculture*

124. Canada has also appealed the Panel's alternative finding that, if Special Classes 5(d) and 5(e) do *not* constitute export subsidies under either Article 9.1(a) or Article 9.1(c) of the *Agreement on Agriculture*, they nevertheless constitute export subsidies under Article 10.1 of that Agreement.[101] This finding was expressly declared by the Panel to be made on the condition that the Canadian measures do *not* fall within Article 9.1 of the *Agreement on Agriculture*. Moreover, the Panel's final conclusions in Section VIII of the Panel Report, contain no reference to this alternative finding. Since we believe that the provision of lower priced milk to processors for export under Special Classes 5(d)

[99] *Supra*, para. 101.

[100] Panel Report, paras. 7.106, 7.111 and 7.112.

[101] See Panel Report, para. 7.133. See also Panel Report, para. 7.117.

and 5(e) constitutes export subsidies, as listed in Article 9.1(c), those subsidies *cannot*, by definition, be "export subsidies *not* listed in paragraph 1 of Article 9", as required by Article 10.1. Therefore, the condition on which the Panel's alternative line of reasoning is predicated does not arise. In these circumstances, both the Panel's reasoning and its finding under Article 10.1 are completely moot and, thus, of no legal effect. There is, therefore, no reason for us to examine Canada's appeal of the Panel's finding under Article 10.1.

VIII. Article II:1(b) of the GATT 1994

125. We approach this last issue by recalling the factual background to this aspect of the dispute. The Panel stated that:

> In Part I of Canada's Schedule to GATT 1994, Canada established a tariff-rate quota for fluid milk (HS 0401.10.10 and 0401.20.10) of 64,500 tonnes. In-quota imports are subject, initially, to a maximum duty of 17.5 per cent (a rate to be decreased to 7.5 per cent in 2001). Fluid milk imports outside of the 64,500 tonnes tariff-rate quota bear an initial rate of duty equal to 283.8 per cent, declining to 241.3 per cent in 2001. In its Schedule, Canada specified under 'Other terms and conditions' that '[t]his quantity [64,500 tonnes] represents the estimated annual cross-border purchases imported by Canadian consumers'.[102]

126. Canada asserts the right, on the basis of these "Other Terms and Conditions", to restrict access to the tariff-rate quota to imports authorized and actually allowed under the relevant practice followed by Canada at the time of the conclusion of the Uruguay Round. In 1970, Canada issued General Import Permit No. 1. The amended version of this Permit provides that "any person may, under the authority of this General Import Permit, import into Canada … any dairy products for the personal use of the importer and his household not exceeding $20 in value for each importation."[103] Nevertheless, for such imports, no individual permits and no customs entries are required and no customs duties are imposed and collected, even in the case of imports within the in-quota quantity.[104] Indeed, Canada

[102]Panel Report, para. 7.142.

[103]General Import Permit No. 1 was amended in 1978 to allow imports of a value of C$20, instead of C$10.

[104]Panel Report, para. 7.143.

does not monitor imports made under the authority of General Import Permit No. 1.[105] Commercial shipments of milk are not, however, allowed by Canada within the tariff-rate quota.[106] The United States claims that the restrictions that Canada places on access to its market for fluid milk are inconsistent with its obligations under Article II:1(b) of the GATT 1994.

127. The Panel found, *inter alia*, that:

> The words "[t]his *quantity represents* the *estimated* annual …" are, in our view, introducing "terms" related to the *quantity* of the quota – i.e., describing the way the size of the quota was determined – rather than setting out "conditions" as to the *kind* of imports qualified to enter Canada under this quota. In particular, the ordinary meaning of the word "represent" in this context does not, in our view, call to mind the setting out of specific restrictions or conditions.[107] (emphasis in original)

128. The Panel went on to state:

> Even if the phrase could be said to include restrictions on access to the tariff-rate quota, we do not see how the two conditions *at issue in this dispute* could be read into this phrase. First, the restriction that only entries valued at less than C$20 qualify for the tariff-rate quota can nowhere be found in Canada's Schedule. Nowhere is any reference made to a maximum value per entry. … [I]n our view, the ordinary meaning of the words "cross-border purchases" by "consumers" in this context does not warrant the conclusion that only *consumer packaged* milk *for personal use* can enter under the tariff-rate quota. An imported good, by definition, crosses a border. Also, the dictionary meaning of "consumer" is not restricted to a person buying *for personal use in small retail packages*. All dictionary definitions of "consumer" referred to by the parties include wider definitions without these restrictions.[108] (emphasis in original)

[105]Panel Report, para. 7.143.

[106]*Ibid*.

[107]*Ibid*, para. 7.151.

[108]*Ibid*., para. 7.152.

129. The Panel held that the meaning of the terms in Canada's Schedule could be gleaned from an examination of the "ordinary meaning [of those terms] in their context and in the light of the object and purpose of GATT 1994."[109] The Panel saw "no need to also examine the historical background against which these terms were negotiated."[110] It noted, furthermore, that the "drafting history … is inconclusive, possibly supporting both the view of Canada and that of the United States."[111] Finally, the Panel concluded that:

> … Canada, by restricting the access to the tariff-rate quota for fluid milk to (i) consumer packaged milk for personal use and (ii) entries valued at less than C$20, acts inconsistently with its obligations under Article II:1(b) of GATT 1994.[112]

130. On appeal, Canada argues, in essence, that the Panel erred by failing to ascribe any meaning, in the sense of "limiting effect", to the language in the notation in its Schedule.[113] In Canada's view, the Panel ought to have established the meaning and content of the language in the Schedule, before considering whether the specific restrictions imposed under General Import Permit No. 1 were justified by that language.

131. We explained in *European Communities – Customs Classification of Certain Computer Equipment* ("*European Communities – Computer Equipment*") that:

> A Schedule is … an integral part of the GATT 1994 …. . Therefore, the concessions provided for in that schedule are part of the terms of the treaty. As such, the only rules which may be applied in interpreting the meaning of a concession are the general rules of treaty interpretation set out in the *Vienna Convention*.[114]

[109]Panel Report, para. 7.155.

[110]*Ibid*.

[111]*Ibid*.

[112]*Ibid*., para. 7.156.

[113]Canada's appellant's submission, para. 152.

[114]Appellate Body Report, WT/DS62/AB/R, WT/DS67/AB/R, WT/DS68/AB/R, adopted 22 June 1998, para. 84.

132. These rules call, in the first place, for the treaty interpreter to attempt to ascertain the ordinary meaning of the terms of the treaty in their context and in the light of the object and purpose of the treaty, in accordance with Article 31(1) of the *Vienna Convention*. However, as we also said in *European Communities – Computer Equipment*:

> … if after applying Article 31 the meaning of the term remains ambiguous or obscure, or leads to a result which is manifestly absurd or unreasonable, Article 32 allows a treaty interpreter to have recourse to:
>
> > ... supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion.
>
> With regard to "the circumstances of [the] conclusion" of a treaty, this permits, in appropriate cases, the examination of the historical background against which the treaty was negotiated.[115]

133. It is also well to recall that the task of the treaty interpreter is to ascertain and give effect to a legally operative meaning for the terms of the treaty. The applicable fundamental principle of *effet utile* is that a treaty interpreter is not free to adopt a meaning that would reduce parts of a treaty to redundancy or inutility.[116]

134. We start our interpretive task by noting that the language at issue in Canada's Schedule is included under the heading "Other Terms and Conditions". Under Article II:1(b) of the GATT 1994, the market access concessions granted by a Member are "*subject to*" the "terms, conditions or qualifications set forth in [its] Schedule". (emphasis added) In our view, the ordinary meaning of the phrase "subject to" is that such concessions are without prejudice to and are *subordinated to*, and are, therefore, *qualified by*, any "terms, conditions or qualifications" inscribed in a Member's Schedule. We believe that the relationship between the 64,500 tonnes tariff-rate quota and the "Other Terms and Conditions" set forth in Canada's Schedule is of this nature. The phrase "terms and conditions" is a composite one which, in its ordinary meaning, denotes the imposition of qualifying restrictions or conditions. A strong presumption arises that the language which is inscribed in a Member's Schedule

[115]*Supra*, footnote 114, para. 86.

[116]Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, p. 23; Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, p. 12.

under the heading, "Other Terms and Conditions", has some *qualifying* or *limiting* effect on the substantive content or scope of the concession or commitment.[117]

135. In interpreting the language in Canada's Schedule, the Panel focused on the verb "represents" and opined that, because of the use of this verb, the notation was no more than a "*description*" of the "way the size of the quota was determined".[118] The net consequence of the Panel's interpretation is a failure to give the notation in Canada's Schedule *any* legal effect as a "term and condition". If the language is *merely* a "description" or a "narration" of how the quantity was arrived at, we do not see what purpose it serves in being inscribed in the Schedule. The Panel, in other words, acted upon the assumption that Canada projected no identifiably necessary or useful qualifying or limiting purpose in inscribing the notation in its Schedule. The Panel thus disregarded the principle of effectiveness in its interpretive effort.

136. We note that the Panel also adopted an overly literal and narrow view of the words "cross-border purchases imported by Canadian consumers" in the notation at issue. Moreover, the Panel erred in failing to give meaning to *all* of the words in that notation. On the basis of its ordinary meaning, the Panel stated that the language in the notation could *not* refer only to "*consumer packaged* milk *for personal use*."[119] (emphasis in original) We do not agree that the ordinary meaning of that phrase in the notation is so unequivocal. We do not see anything in the text of the notation which necessarily *precludes* such an interpretation. The notation refers to "cross-border purchases imported by Canadian consumers". It seems, to us, that this language may well be taken to refer to imports of fluid milk made by Canadian consumers for personal use in the course of cross-border shopping.

137. Moreover, we do not share the Panel's view as to the significance of the object and purpose of Article II of the GATT 1994 for the interpretive question at issue. It is true, as the Panel said, that the object and purpose of Article II is "to preserve the value of tariff concessions…".[120] However, the issue facing the Panel was what was the *scope and content* of the concession? The Panel's reference to the object and purpose of Article II appears to us to beg the very question that the Panel should

[117]The United States contends, on the basis of the panel report in *United States – Restrictions on Imports of Sugar* (*supra*, footnote 52), that "terms and conditions" may encompass "additional concessions". We take no position as to whether "terms and conditions" may encompass "additional concessions"; but we do, however, note that, even assuming that the United States is correct on this point, an "additional concession" may well embody a qualification to a concession by expanding its scope or adding to it.

[118]Panel Report, para. 7.151.

[119]*Ibid*., para. 7.152.

[120]See Panel Report, para. 7.154. The Panel is citing from our Report in *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel, and Other Items*, adopted on 27 March 1998, WT/DS56/AB/R, para. 47.

have addressed: namely, what *is* the meaning of that notation? That is, what *is* the shape and tenor of the concession that Canada had set forth in its Schedule of Commitments?

138. In our view, the language in the notation in Canada's Schedule is *not* clear on its face. Indeed, the language is general and ambiguous, and, therefore, requires special care on the part of the treaty interpreter. For this reason, it is appropriate, indeed necessary, in this case, to turn to "supplementary means of interpretation" pursuant to Article 32 of the *Vienna Convention*. In so doing, we are unable to share the apparent view of the Panel that the meaning of the notation at issue is so clear and self-evident that there was "*no need* to also examine the historical background against which these terms were negotiated."[121] (emphasis added)

139. In considering "supplementary means of interpretation", we observe that the "terms and conditions" at issue were incorporated into Canada's Schedule after lengthy negotiations between Canada and the United States, regarding reciprocal market access opportunities for dairy products.[122] Both Canada and the United States agree that those negotiations failed to produce any agreement between them.[123] Our reading of the circumstances surrounding the conclusion of the *WTO Agreement* leads us to observe that, although Canada's commitment on fluid milk was made unilaterally[124], both Canada and the United States understood that this commitment represented a continuation by Canada of "current access" opportunities, not a commitment to provide "minimum access" opportunities under the *Agreement on Agriculture*.[125]

[121]Panel Report, para. 7.155.

[122]Canada's appellant's submission, para. 173; United States' appellee's submission, para. 148.

[123]Canada's appellant's submission, para. 176; United States' appellee's submission, paras. 146 and 148.

[124]This is borne out by the positions taken by both Canada and the United States in this appeal. See Canada's appellant's submission, paras. 173 to 176, and the United States' appellee's submission, paras. 146 and 148.

[125]The Panel stated that "[t]he United States, on the other hand, submits that the *phrase at issue was added to clarify that the tariff-rate quota was a continuation of 'current access' opportunities already available before the Uruguay Round negotiations*; not a phrase limiting access to the quota as such. In so doing, the United States argues, Canada avoided granting the 'minimum access opportunities' for products for which there are no significant imports (ranging from 3 to 5 per cent of domestic consumption) referred to in the Agreement on Modalities for the Establishment of Specific Binding Commitments under the Reform Program … ." (emphasis added) (Panel Report, para. 7.155, footnote 530) See also the summary of the United States' submissions to the Panel at paragraph 4.499 of the Panel Report.

140. The next issue we must address is whether the measure promulgated by Canada in the form of General Import Permit No. 1 is consistent with the commitment for fluid milk in Canada's Schedule, as we read it. General Import Permit No. 1 authorizes:

> Any person … [to] *import into Canada* from any country … *any dairy products* for *the personal use* of the importer and his household *not exceeding $20 in value for each importation*. (emphasis added)

141. The first condition of General Import Permit No. 1 is that the dairy products, including fluid milk, imported into Canada must be for "the personal use of the importer and his household". This condition appears to us to be reflected in the following phrase in the notation in Canada's Schedule: "cross-border purchases imported by Canadian consumers". General Import Permit No. 1 allows, in the words of the notation, "Canadian consumers" to "import into Canada" fluid milk and other dairy products that they purchase in the United States. These are, therefore, "cross-border purchases" for the "personal use" of Canadian importers. Thus, we see the first condition of General Import Permit No. 1 as consistent with the notation at issue in Canada's Schedule.

142. The second condition of General Import Permit No. 1 is that the value of "each importation" of any "dairy products" not exceed "$20 in value". In this connection, we note that General Import Permit No. 1 applies to "dairy products" generally, not just to fluid milk. The tariff-rate quota commitment and the accompanying notation in Canada's Schedule, however, apply only to "fluid milk". Moreover, the notation at issue in Canada's Schedule does not place any limit on the value of each importation. To the extent that the second condition of General Import Permit No. 1 is not reflected in the notation at issue, the Canadian measure is not consistent with Canada's commitment on fluid milk set forth in its Schedule.

143. In light of the foregoing, we do not agree with the Panel's interpretation of the notation at issue relating to the tariff-rate quota commitment on fluid milk in Canada's Schedule. Nor do we agree with the Panel's finding that by restricting access to the tariff-rate for fluid milk to "consumer packaged milk for personal use", Canada acts inconsistently with its obligations under Article II:1(b) of the GATT 1994. However, we do agree with the Panel's finding that by restricting access to the tariff-rate quota for fluid milk to "entries valued at less than C$20", Canada acts inconsistently with its obligations under Article II:1(b) of the GATT 1994.

IX. Findings and Conclusions

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

(a) reverses the Panel's interpretation of the terms "direct subsidies" and "payments-in-kind", as used in Article 9.1(a) of the *Agreement on Agriculture*, and, in consequence, reverses the Panel's finding that Canada, through Special Milk Classes 5(d) and 5(e), has acted inconsistently with its obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture* by providing export subsidies as listed in Article 9.1(a) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule; but, in light of the finding in paragraph (b) below, sees no reason to examine whether export subsidies as listed in Article 9.1(a) are conferred through Special Milk Classes 5(d) and 5(e);

(b) upholds the Panel's finding that Canada, through Special Milk Classes 5(d) and 5(e), has acted inconsistently with its obligations under Article 3.3 and Article 8 of the *Agreement on Agriculture* by providing export subsidies as listed in Article 9.1(c) of that Agreement in excess of the quantity commitment levels specified in Canada's Schedule;

(c) declines to examine the Panel's alternative finding under Article 10.1 of the *Agreement on Agriculture* since, in light of our finding in paragraph (b) above, that alternative finding has no legal effect; and

(d) reverses the Panel's finding that Canada, by restricting access to the tariff-rate quota for fluid milk in its Schedule to consumer packaged milk, imported by Canadian consumers for personal use, acts inconsistently with its obligations under Article II:1(b) of the GATT 1994; but upholds the Panel's finding that Canada, by restricting access to the tariff-rate quota for fluid milk in its Schedule to entries valued at less than C$20, acts inconsistently with its obligations under Article II:1(b) of the GATT 1994.

145. The Appellate Body recommends that the DSB request that Canada bring its measures found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with its obligations under the *Agreement on Agriculture* and the GATT 1994 into conformity with those agreements.

Signed in the original at Geneva this 23rd day of September 1999 by:

_____

Mitsuo Matsushita
Presiding Member

_____ _____

Florentino Feliciano
Member

Julio Lacarte-Muró
Member

WORLD TRADE ORGANIZATION

WT/DS103/AB/R/Corr.1[1]
WT/DS113/AB/R/Corr.1[2]
18 October 1999

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

Report of the Appellate Body

Corrigendum

In the header of the Table of Contents on Page ii, the document number "WT/DS46/AB/R" should read "WT/DS103/AB/R, WT/DS113/AB/R".

[1]In English only.
[2]*Ibid*.